

TAXATION AND EXCISE DUTIES IN ESTONIA

Monika Sadilov, Kandela Õun
University of Tartu Pärnu College^a

The article provides an overview of the tax system, principles of tax policy and the impact of excise duties on consumption. The authors try to determine whether the rise in excise duties has reduced the consumption of the relevant products. Possible future developments in Estonia's tax policy are analysed. A comparison with Nordic countries and other European countries helps to assess the situation in Estonia and identify possible correlations.

Introduction

States get most of their budget funds from tax revenue. Therefore, the creation of an efficient and optimum (for the given country) tax system is one of the most important tasks of any government. Contemporary tax systems include all kinds of taxes, levied on consumption as well as income. At the same time, the introduction of a new tax always causes many questions and problems. The government should make sure that the potential tax revenue is sufficient and that the costs of collecting the new tax do not render its imposition impractical. Excise duties have a great impact on consumption: the goal is to reduce the consumption of certain products (e.g. alcohol and tobacco products), the excessive consumption of which is a problem in many countries.

Principles of tax law, taxation and tax system

What makes for a good and efficient tax system? According to the economist and tax theoretician Joseph E. Stiglitz, a good tax system should meet the following five criteria:

- taxes are economically efficient;
- the taxation process is simple and inexpensive;
- the tax system reacts quickly to changing economic conditions;
- people know what they are paying for;
- the tax system is fair to people (Stiglitz 1995: 390).

Inexpensiveness of a tax system means that any tax changes planned by the government should be implemented with the minimum possible cost. It would be impractical to introduce a tax, if its collection is very costly and a great burden for the country's tax authorities. It is important to always make sure that the revenue from the collected tax is sufficient and fulfils the purpose. The tax system should also be transparent, meaning that taxpayers know what they are paying the tax for and can see how the tax revenue is spent.

It is essential that the creation of a tax system is based on the right principles and needs. The four main elements in the creation of a tax system are:

- goals established by the government;
- the voters' reaction to policy effects;
- the framework of political struggle which determines the government's strategies;
- any restrictions on the government and taxpayers, arising from the general balanced structure of the private economy (Musgrave 1989: 42–43).

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Taxes can be classified into property, personal, environmental, income, social and consumption taxes. There are direct and indirect taxes and social security contributions. **Direct taxes** are paid by the taxable person; these include personal income tax, corporate income tax, property tax and most local taxes. **Indirect taxes** are levied on production and consumption and are paid by business owners, who add the tax cost to the price charged from end-consumers (e.g. value added tax, excise duties). **Social security contributions** (also called labour taxes) are mandatory taxes collected by social insurance agencies for the payment of benefits for sickness, unemployment or incapacity for work (e.g. health insurance benefits and different types of pension). Social security contributions are paid by employees and employers.

Property and personal taxes are periodic taxes, such as real estate tax, land tax, inheritance tax, gift tax, financial transaction tax, capital gains tax and wealth tax. **Consumption taxes** can be divided into general and specific taxes. General consumption taxes do not affect the prices of the taxed products and services compared to other similar products and services, whereas specific consumption taxes do change the prices of products. Consumption taxes are, for example, value added tax, sales tax and turnover tax. Sales tax is a tax levied on a product or service only once, upon its sale to the end-consumer. (Nömmann et al 2003: 52–67).

Excise duties are another type of specific consumption tax, in addition to value added tax. The Dutch economist Sijbren Cnossen has listed several reasons for the implementation of excise duties: increase state revenue for general purposes, limit consumption, tax road users (Cnossen 2005: 3–7). Excise duties are introduced for the purposes of public health, as a way to limit the consumption of unhealthy products, and for environmental protection (e.g. fuel excise duty). It is important to raise excise duty rates in order to discourage smoking and drinking, especially among young people (ibid.: 5). The tax expert Lasse Lehis has written that excise duties have been levied on a wide range of convenience goods and luxury goods (Lehis 2007: 40–43). Today, governments have gradually started to curb taxation on less-used products, because the costs of taxation may exceed the tax receipts.

Tax law is an important part of tax policy. It is a part of financial law and covers the essence and purpose of taxes, types of taxes, the foundations and principles of tax law, tax claims and tax liabilities, tax proceedings and penal power (Kavald 2012). The term 'international tax law' refers to those tax-related legal regulations that have international implications. The objective of the provisions of international tax law is to eliminate conflicts between the legal provisions of different national tax laws that cause double taxation or allow tax evasion. The scope of international tax law includes:

- ensuring uniform taxation;
- ensuring neutral taxation;
- the fair distribution of tax revenue between countries;
- cooperation for the prevention of tax evasion (Rahvusvaheline ... 2011).

It means the prevention of double taxation and discrimination; restriction of unfair tax competition; information exchange and professional assistance, for example, in the collection of evidence, in the personal delivery of administrative acts and in the collection of tax arrears.

Willingness to pay taxes depends on individual behaviour and the factors that affect this. Compliance with the provisions of tax law has been studied with the help of economic models. According to Kerly Lillemets (Kerly Randlane since 2011), the head of the debt recovery division of the Estonian Tax and Customs Board, (compliance with the provisions of tax law depends on the taxpayers' behaviour, conditioned by psychological factors (Lillemets 2010: 238–239). J. E. Stiglitz, winner of the 2001 Nobel Prize in Economic Sciences, has written that any tax system influences behaviour. The government takes money away from people and it is understandable that people react somehow to this decrease in their incomes (Stiglitz 1995: 392). Simplicity and fairness are vital for any tax system. Tax systems are usually quite complicated and it is difficult to understand all the details if you do not have the relevant education. The second aspect – fairness – means that citizens should feel that all citizens of that country are

treated equally and their contribution to the national tax system is determined on the basis of individual ability to pay tax.

It is quite common that governments fail to consider the impact of tax on goods as a source of tax revenue when taxes are imposed on goods, and the impact of tax on use of income when taxes are imposed on production inputs (people buy less). Therefore, it is useful to know some principles of tax theory, which may or may not be taken into account in the development of a national tax system. It has become an axiom that a person's economic behaviour is the least (or not at all) affected by a lump sum tax (i.e. a tax with a fixed amount). Lump sum taxes are not popular among politicians, because in case of these taxes it is difficult to observe the ability-to-pay principle and the imposition of a general lump sum tax (such as several personal or head taxes) makes taxation very unfair. For that reason, lump sum taxes are considered the standard of efficiency, but they have marginal importance as an instrument of tax policy. (Ulst, Hanson 1996: 55, 57).

Tax revenue is the most important source of revenue for the state budget. Taxes provide the state with funds for general administration and provision of services to its citizens. All people use the benefits offered by the society, but if people do not pay taxes, the state will not have enough funds and these benefits will become unavailable. (Maksud ... 2011). The aim of the Estonian Government is to partially restructure the tax system, thereby shifting the tax burden from income taxation to taxation of consumption, use of natural resources and environmental pollution. The Government tries to keep the tax system simple, stable and transparent, with a minimum amount of exceptions and differences. (Riigi ... 2011).

The biggest source of revenue in the budget of the Republic of Estonia in 1994–1999 was value added tax (VAT), followed by personal income tax and excise duties. Until 2000, revenue from social tax (which was comparable to VAT revenue) was not counted as a part of the state budget. Social tax receipts and the use of this revenue for specific purposes was outlined in an annex to the budget. The excise duty system was also based on principles generally recognised in the European Union. The share of excise duties in state budget revenue doubled in 1994–1999, because the population's ability to pay was very low following the currency reform. As a result, the Government established low excise duty rates at first and the rates were repeatedly and significantly raised over this period. (Raju 2012).

A bigger state budget also means bigger taxes. In turn, taxes reduce the resources available to households, thereby also lowering the level of well-being. In the years of recession (2008–2010), Estonia's GDP fell by more than 20% and essentially diminished the state budget. In 2010, O. Raju wrote, referring to tax receipt statistics, that the tax system had not been able to ensure a stable stream of budgetary revenue and the decrease in budgetary revenue led to serious consideration of raising the tax burden in Estonia (Raju 2010: 347–348). The Estonian Government does not currently have plans to increase the general tax burden, but certain measures have been taken, including a rise in some tax rates (value added tax rate raised to 20% in 2009; excise duty rates).

It is virtually impossible for the Government to change its policy only in one area. The Government must comply with budgetary restrictions: tax revenue plus deficit increase (annual increase in government debt) must equal total expenditure. Putting up taxes is an issue that all governments face from time to time. The current situation in Europe has also put a strong focus on taxes. If revenue is not sufficient, governments have to find solutions to many complicated problems. Borrowing money is only a temporary solution; mostly, governments have no other choice but to raise taxes. Changing tax rates is always a complicated process. It may entail changes that were not planned originally. Since every tax change is associated with many problems, governments must carry out a thorough analysis before taking any action and consult the experts of the relevant field. Hastily made changes cause problems and, in the long run, the damage may even be greater than the gains.

In the coordination of economic policy, sustainability of the state budget, increasing the efficiency of government expenditure and improving the quality of revenues are considered especially

important by the Estonian Government. Estonia's goal is to preserve its stable and simple tax system. Estonia supports the overall idea that indirect taxes in the European Union should be harmonised, i.e. there should be as few exceptions in the VAT and excise duty system as possible. A uniform consolidated tax base is being developed for corporate income tax – from Estonia's perspective, it is important that the solution would have a wide tax base, be simple and transparent and would not adversely affect the enterprises operating in Estonia. (Raig 2008: 175–176). According to the economist O. Raju (2009), the characteristics of the Estonian tax system have been a relatively low tax burden, a level of simplicity approaching primitivism (which has reduced the role of taxes as an automatic stabiliser) and the big proportion of indirect and consumption taxes. Among fundamental changes has been the experiment that virtually abolished corporate income tax starting from 2000. The social tax system in Estonia is unique, as no other similar systems are known. (Raju 2009: 73–74). It is very difficult to develop a tax policy that satisfies all stakeholders. Heldur Meerits, an investor and one of the founders of Hansapank, has stated in his book "Väikesed ja suured" that, in terms of the tax base, Estonia should continue its current policy that allows very few exceptions (Meerits 2009: 71)

In 2011, Eurostat and the European Commission issued a publication on taxation trends in the European Union, comparing tax systems and tax policies. One of the main observations is that, on average, the European Union is a high tax area and the tax burden is higher than in many non-EU countries. In that report, Estonia is ranked in the middle, with a few top and bottom positions. For example, the share of consumption taxes in Estonia is one of the highest in the European Union. In case of capital taxes, Estonia is at the bottom with Latvia and Lithuania. The same report mentions Estonia in connection with the sharp rise in tax burden (Tingas 2011: 32–34).

Efficiency is an important aspect of taxation, but fairness is even more important. Many authors believe that a good tax system should be simple. But there are also authors who believe that excessive simplicity in a tax system leads to a situation where all taxpayers are considered equal (also in terms of their ability to pay tax). Since people from different social strata have a different ability to pay, governments should use exceptions and incentives more frequently and a simple solution is not always efficient and fair. The authors of this article believe that the high tax burden in Europe is not sustainable in the long term, although it may have been necessary temporarily. The tradition of paying big pensions and benefits is changing, since the population of Europe is ageing and there are fewer taxpayers. It can already be foreseen that tax policies will need to be changed all over Europe in the very near future.

Estonia joined the European Union in 2004 and thereby also became a competitor in the common market. The competition concerns both goods and production inputs. At the time of accession, Estonia could not compete with other countries in terms of the wages paid to the labour force. Therefore, a substantial flow of labour to Europe was likely. External labour migration usually causes a fast growth in wages and offers an opportunity to vigorously restructure the tax system as well as local government financing. (Raju 2012). The tax system should be changed due to the great share of indirect taxes in Estonia, which have a greater impact on people with small incomes and contribute to social inequality. There was no sharp rise in wages in 2012, but the loss of labour force to other European countries is becoming a problem for Estonia.

Excise duties and their impact on consumption

Excise duties are consumption taxes which are used to tax a specific group of commodities (Lehis 2007: 40). Excise duties have been used since the restoration of Estonia's independence, but the duty rates have continually increased and the taxation objects have also changed. Excise duties are indirect taxes and in that respect similar to value added tax. Value added tax can be considered a universal consumption tax, while excise duties are additional specific taxes next to value added tax (ibid.: 40). The tax burden is borne by end-consumers who use excise goods non-commercially, but the tax is collected and paid by the enterprises that produce or import goods. Consumption is taxed by increasing the price of products. For consumers, excise tax is more hidden than value added tax, because the seller's invoices do not specify the

excise duty included in the price paid. In addition to the fiscal purpose (generation of state revenue), excise duties also have a considerable role in limiting consumption and regulating the market. Excise duties limit the consumption of goods that are bad for health or the environment. (Elling 2012).

The purpose of excise duty is to tax the consumption of specific goods regardless of the origin of the goods. In the first years after the restoration of independence, domestic beer and tobacco products were subject to lower excise duty rates in Estonia, but the Government was forced to stop such preferential treatment on the order of the European Union and the World Trade Organization (WTO). In Estonia, the following goods are subject to excise duty:

- alcohol
- tobacco products
- fuel
- natural gas
- electricity
- packaging (Elling 2012).

According to the estimate of the Ministry of Finance, revenue from excise duties will increase by 6.2% on average in the period 2012–2015 and the projected revenue for 2015 is 877.4 million euros. The receipts of tobacco excise duty were boosted by the 10% increase in the tax rate in 2012 and will be boosted further by a similar tax increase in 2013. (Riigi ... 2011). The rising excise duty rates should increase the revenue received by the state, provided that there is no upsurge in illegal trade. The current Alcohol, Tobacco, Fuel and Electricity Excise Duty Act, which was adopted on 4 December 2002, has been amended 26 times (most recently on 1 January 2013). The main reason for these amendments has been the need to raise excise duty rates.

Since excise duties affect the prices of goods and thus the imposition of excise duties may hinder the free movement of goods in the common market, the European Union is harmonising the regulations concerning excise duties. The main legal act governing this is Council Directive 92/12/EEC of 25 February 1992 on the general arrangements for products subject to excise duty and on the holding, movement and monitoring of such products (the so-called horizontal Directive). The directive regulates three excise duties: alcohol, tobacco and fuel excise duties. With Estonia's accession to the EU, the customs frontier between Estonia and EU Member States was abolished, but excise duties are still imposed based on the country of destination. Taxation also depends on whether the goods are being purchased by an enterprise or natural person of the other country. (Lehis 2007: 42–43).

The Estonian tax system, including excise duties, has undergone many changes over twenty years. The early 1990s were a period when the tax system was still being built, making constant changes an inevitability. On the other hand, Estonia's accession to the European Union in 2004 also meant some obligatory changes. Excise duty rates were mostly raised. Since the consumers' ability to pay has grown steadily, excise duty rates have also increased.

Tobacco excise duty rates were raised gradually over six years after accession. The outcome of this complicated system of changes is an increase in the prices of tobacco products. Considering the relatively low price elasticity of tobacco products, the tax incidence falls mostly on buyers, meaning that the burden of this tax is ultimately borne by consumers. (Raju 2012). In the European Union, tobacco products are subject to a minimum rate of excise duty which the Estonian Government must also comply with. In Estonia, the excise duty rate for cigarettes was most recently raised on 1 January 2013; the last tax raise before that took place at the beginning of 2012. The average cost of a pack of legal cigarettes rose to 2.21 euros in 2010 (from 2.04 euros in 2009), causing a simultaneous increase in the price of illegal cigarettes. Although contraband cigarettes are significantly cheaper than legal cigarettes, the price difference between the two has decreased over time. At the end of the 1990s, illegal cigarettes were, on average, two times cheaper than legal cigarettes. Their prices differed 2.5 times in 2008 and again

two times in 2009. But in 2010, legal cigarettes were 1.8 times more expensive than illegal cigarettes. (Orro et al. 2011a: 17).

Tobacco excise duty rates have increased since 2006, although not every year. There has been no rise in the excise duty rates for cigars and cigarillos. The possible reason is that their tax rate is already high and these products are probably consumed less than cigarettes. The duty rate for cigarettes has increased the most. The Estonian Parliament has passed amendments to the excise duty act, whereby the excise duty rate for tobacco products will rise 10% in 2013. After this raise, the duty rate charged in Estonia will be closer to the EU minimum rates for tobacco products that enter into force in 2014. As a result of this raise, the average retail price of cigarettes is expected to increase to about 2.56 euros per pack. In 2013, the minimum excise duty payable on cigarettes will rise from 80 euros (the rate in 2012) to 84.80 euros per 1,000 cigarettes. Estonia has to raise the minimum excise duty payable to 90 euros per 1,000 cigarettes by the end of 2017 the latest. The excise duty rate for cigarettes will be raised from the level 42.18 euros + 33% (the rate in 2012) to the level 47.63 euros + 33%. The rising excise duty rates for tobacco products are expected to increase the revenue from excise duties and VAT by nine million euros in 2013. The raise also contributes to public health protection and may reduce legal consumption by nearly four percent. In 2012, the excise duty rate for tobacco products was also raised by 10% (Maksu- ja Tolliamet 2012).

Figures 1 (p. 61) and 2 (p. 61) offer an overview of tax receipts and the share of excise duties in tax revenue in Estonia in 2006–2010. Since 2006, the share of alcohol excise duty in total revenue from excise duties has increased by 0.29 percentage points and the share of tobacco excise duty by 0.64 percentage points – thus, the share of tobacco excise duty has increased more.

In 2010, the revenue from alcohol excise duty was 165.21 million euros, which accounted for a quarter of total state revenue from excise duties. Since 2000, receipts of alcohol excise duty have decreased by about 11 percentage points. In 2010, alcohol excise duty accounted for 4.1% of Estonia's total tax revenue. Since the alcohol excise duty rates were raised in 2010 (by about 10%), the share of alcohol excise duty in total tax revenue increased a little in both 2009 (greater quantities were bought before the tax raise) and 2010. In the EU, Estonia is among those countries that impose relatively high duties on alcohol (Orro et al. 2011b: 16). Tax revenue decreased in 2009 and 2010, but the revenue from alcohol excise duty was on the rise. The revenue from excise duties has increased in general (Figure 1, p. 61). One of the reasons is the higher rates of excise duty, but also the efforts of the Estonian Tax and Customs Boards in the collection of taxes and in the discovery of violations.

Consumption of alcoholic beverages and excise duties

Next, the consumption of alcoholic beverages and the impact of excise duties on consumption will be analysed. Since one of the reasons for the implementation of excise duties is the restriction of consumption, it would be interesting to see whether the excise duties have had the desired impact. Alcohol policy covers more than taxation, although taxes are an important part of this policy. There are many problems in this area. In Estonia, one of the biggest problems is that alcohol is sold in very many places. According to the Estonian Institute of Economic Research, the number of sales points selling strong alcoholic beverages per 100,000 inhabitants in Estonia was 197 in 2011 (Orro et al. 2011b: 89). The same figure is only 6 for Finland and 5 for Norway. As defined in this article, alcohol comprises beer, wine, intermediate products and other alcohol (Alkoholi- ... 2002). Figure 3 (p. 62) outlines the alcohol excise duty rates in 2010 in Estonia, Finland and Sweden and in the European Union on average.

Estonia has lower excise duty rates than Finland and Sweden. Although the excise duty rates in Estonia are higher than the EU minimum rates, there is enough room for improvement. The excise duty rate for strong alcoholic beverages in Estonia is 25.31 euros lower than in Finland and 35.02 euros lower than in Sweden. The difference in duty rates is justified, since Estonian consumers have a lower ability to pay tax. But it could be asked if the excise duty rates

are optimal. In the 4th quarter of 2010, average monthly wages in Estonia were 814 euros according to Statistics Estonia, and the average monthly wages in Finland were 2,600 euros according to the Finnish Working Life Information Point (Keskmine ... 2011; Information ... 2012). The difference in wages is more than threefold, but the difference in excise duty rates is slightly smaller. Thus, the current excise duty rates for strong alcoholic beverages in Estonia seem reasonable. The duty rates should be raised when the average wages increase. At the same time, the rise in excise duty rate should not be greater (in percentage terms) than the increase in wages, as this may lead to greater consumption of illegal alcohol and, as a result, the state will lose tax revenue. Figure 4 (p. 63) shows the development of alcohol excise duty rates in Estonia.

The biggest increase has occurred in the excise duty rate for other alcohol, i.e. strong alcoholic beverages. Since 2006, beer excise duty has risen by 1.72 euros, wine excise duty by 9.91 euros, the excise duty for intermediate products (18% ethanol content) by 48.83 euros and the excise duty for other alcohol by 447.38 euros. The excise duty rates have risen steadily and show a continuing upward trend (in 2012, beer excise duty was 5.7 euros). This can be considered a positive development, because alcohol consumption has to be limited and raising prices is one way to do this. In Germany, for example, beer excise duty is lower (1.97 euros in 2010) than in Estonia (5.43 euros in 2010), but we cannot model our tax system after the German practice and traditions (Orro et al. 2011b: 90). It is important to consider the specific nature and culture of each country. Culturally speaking, Estonia is closer to the Nordic countries than Central European countries.

Figure 5 (p. 63) outlines the consumption of alcohol in Estonia based on a survey of the Estonian Institute of Economic Research. It indicates that the amount of alcohol sold and consumed in Estonia has decreased over the years.

The price of alcohol depends on excise duty (among other things) and the price affects the quantity of alcohol bought. High prices may boost the sales of illegal alcohol. The survey conducted by the Estonian Institute of Economic Research did not show any significant increase in the sales of illegal alcohol. In 2003, illegal sales amounted to 1.1 litres of pure alcohol per inhabitant, whereas in 2010 this figure was 0.67 litres of pure alcohol per inhabitant. There has been a downward trend, which will continue with the right alcohol policy. Figure 5 (p. 63) shows that alcohol consumption was the highest in Estonia in 2007, after which it has been in decline. In 2006–2010, the quantity consumed has decreased by 1.72 litres per inhabitant, while the excise duty rate for strong alcoholic beverages has increased.

In its survey, the Estonian Institute of Economic Research lists the prices of alcoholic beverages in supermarkets in the residential districts of Tallinn and other European capitals. It shows that in 2010 a 0.5-litre glass bottle of beer cost 0.87 euros in Tallinn, 0.7 euros in Riga and 2.02 euros in Helsinki (the prices include VAT and the bottle deposit). In case of vodka (alcohol content 38–40%), the price was 8 euros in Tallinn, 6.21 euros in Riga and 16.35 euros in Helsinki for a 0.7–0.75-litre glass bottle of vodka (Orro et al. 2011b: 40). In Helsinki, alcoholic beverages are significantly more expensive than in Tallinn and Riga; at the same time, the prices in Riga are cheaper than in Tallinn. Alcohol policy is also pricing policy, and if the prices in Estonia are much higher than the prices in neighbouring countries, it is likely that people will go and buy alcohol where it is cheaper. In its tax policy, Estonia has to consider the tax policy of Latvia, because the lower prices in Latvia attract Estonian customers to buy alcohol in Latvia (just like the cheaper prices in Estonia attract Finnish customers to Estonia).

Figure 6 (p. 64) compares alcohol consumption in Estonia and in the Nordic countries. It also shows the excise duty rates for strong alcoholic beverages.

Compared to Norway, the excise duty rate in Estonia is 57.68 euros smaller and the quantity of alcohol consumed is 3.7 litres bigger. The figure shows a clear connection between the excise duty rate and the amount of alcohol consumed: the correlation coefficient is $r = -0.95$. This is a strong negative correlation, meaning that consumption is smaller with higher tax rates, and vice versa. If we compare the excise duty rates for wine, beer and strong alcoholic beverages in Estonia and alcohol consumption in 2006–2010, the correlation coefficient is $r = -0.70$.

Thus, there is a strong negative correlation here as well. Since higher excise duty rates mean smaller consumption, Estonia should also continue to raise the duty rates for alcoholic beverages. When raising alcohol excise duty rates, it is important to remember that the retail price of alcohol should increase slightly faster than people's incomes and faster than the prices of other goods – consumption can be influenced through pricing. The tax rates should not be raised too sharply, as this might lead to increased consumption of illegal alcohol and cause more work for the Estonian Tax and Customs Board and the police. Based on the data provided by S. Raidma, Chief Specialist at the Estonian Tax and Customs Board, the quantity of pure alcohol seized by the customs control authorities decreased from 2008 (49,240 litres) to 2010 (11,763 litres), but then rose in 2011 (57,644 litres) (Raidma 2012). Thus, the data for at least three years show that the raising of duty rates has not caused an increase in the quantity of illegal alcohol smuggled into Estonia. Introducing changes in taxation is always a complicated process, but changes are inevitable in certain situations.

Consumption of tobacco products and tobacco excise duties

As defined in this article, tobacco products comprise cigars, cigarillos, cigarettes, smoking tobacco and chewing tobacco (Alkoholi- ... 2002).

According to the study "Health Behaviour Among Estonian Adult Population, 2010" carried out by the National Institute for Health Development and covering the population aged 16–64, 37% of men and 19% of women in Estonia smoke every day. In the age group 16–64, the share of smokers among women is two times smaller than among men. About a quarter of men and slightly more than half of women have never smoked. Based on the level of education, the share of smokers is the biggest among people with primary or basic education – as much as half of men and 35% of women. The share of smokers is the smallest among people with higher education: 18% of men and 11% of women. The share of smokers among men in rural areas is bigger than in urban areas, whereas in case of women the share of smokers is bigger in urban areas (except for Tallinn). The share of smokers is the biggest among the unemployed, people who live alone and people (both men and women) with a low income (Rahno 2011: 46).

According to the study of the Estonian Institute of Economic Research, 24% of the adult population in Estonia were smokers in 2010. The proportions of non-smokers and smokers did not change very much compared to the previous year. The share of non-smokers was 76%. However, there has been an increase in the share of daily smokers among smokers – from 17% in 2009 to 19% in 2010. The share of occasional smokers among smokers has fallen from 8% in 2009 to 5% in 2010. After 2007 (when 31% of the respondents were smokers), the share of smokers has been in decline. In 2010, daily smokers smoked 14 cigarettes per day on average, which was the same as in 2009. Smoking is more common among men, but the share of men among smokers has steadily decreased. In 1979, the share of smokers was 49% among men and 18% among women – the latter has not decreased over the years. In recent years, the share of women among smokers has increased (Orro et al. 2011a: 5).

Figure 7 (p. 65) outlines the excise duty rates for cigarettes and the sex distribution of smokers in Estonia in 2006–2010. Since cigarettes are the most popular tobacco product, the excise duty rate for cigarettes has been used as the basis.

Since 2008, the share of smokers has decreased, but the spread of smoking among women is a problem. There is a negative correlation between the share of smokers and the excise duty rate – $r = -0.89$. It is likely that the raising of excise duty rates has reduced the share of smokers. Figure 7 (p. 65) and the correlation coefficient indicate that the excise duty rate has achieved the desired result. Further studies over a longer period will show whether this trend continues and whether a rise in the excise duty rates would achieve the desired outcome in the future as well.

Figure 8 (p. 66) shows the excise duty rates for cigarettes in Estonia and compares the share of smokers in Estonia and in other selected European countries.

There is a negative correlation (correlation coefficient $r = -0.83$), whereby the share of smokers has decreased as duty rates have risen. According to 2008 data, the share of smokers was the biggest in Latvia and the smallest in Sweden (among the countries compared). The excise duty rate for cigarettes was 72.82 euros per 1,000 cigarettes in Latvia and 140.25 euros per 1,000 cigarettes in Sweden. The share of smokers was 27.9% and 14.5%, respectively. We can conclude that a higher duty rate for cigarettes is one of the reasons for the decreased share of smokers.

In its report, the WHO Regional Office for Europe has made several policy recommendations for limiting the consumption of tobacco products (Joint ... 2011: 44). One of the recommendations is that the excise duty rates for cigarettes and for smoking tobacco (for rolling of cigarettes) should be harmonised, as the difference is currently too big and could encourage the choice of the cheaper product. However, higher tax rates and the resulting higher prices could cause an unwanted boost in illegal trade. The only solution is to educate the population, so that people choose the legal products because they consider it to be the right thing to do. Illegal trade cannot be abolished completely, but it is always possible to make more efforts to reduce it. Many people in Estonia struggle financially, which forces people to buy where it is cheaper. The survey conducted by the National Institute of Economic Research in 2011 showed that in recent years there has been an increase in the share of respondents who do not buy illegal cigarettes, because that would mean supporting the criminal world. In 2010, this reason was cited by 43% of people smoking legal cigarettes, up from 38% in 2009. There has been a rather significant decrease in the share of respondents who said that their financial situation allows them to buy legal cigarettes. In 2009 this response was given by 44% of people smoking legal cigarettes, while in 2010 only 37% chose this response. This indicates that the average purchasing power of consumers decreased due to widespread unemployment and reduced incomes, while the price of legal cigarettes increased (Orro et al. 2011a: 8–9). The situation could be improved by adopting a national tobacco policy, allocating funds for prevention and raising awareness.

The share of illegal cigarette trade has increased compared to 2009 (when it was 25–30%), as in 2010 the share of illegal cigarettes in the domestic cigarette market was 27–31%, according to the estimate of the National Institute of Economic Research (Table 1, p. 67). Compared to 2009, the quantity of illegal cigarettes sold did not change, but the value of sales increased. It is estimated that the state lost about 57 million euros of excise and VAT revenue due to illegal trade in 2010, which is a significant amount (Orro et al. 2011a: 24). When tax rates are raised, there is always the risk that illegal trade will spread and increase, but this cannot be an obstacle to the imposition of taxes. The state must find ways to restrict illegal trade. According to the customs control authorities, the quantity of illegal cigarettes seized has varied greatly from year to year. The number of illegal cigarettes seized was 6.5 million in 2008, 14.7 million in 2009 and 9.9 million in 2010 (Raidma 2012). Although the excise duty rate was not raised in 2009, the number of cigarettes seized increased. In 2010, the excise duty rate increased, but the quantity of cigarettes seized decreased. These data suggest that an increase in the tobacco excise duty rates does not have any significant impact on illegal cigarette trade. Instead, the reason could be more successful efforts of the customs control authorities.

Conclusion

The imposition of a fixed tax rate is complicated: the tax rate should not be too high (so that it hinders economic growth) nor too low (making governments unable to cover their expenditure). Tax policy is the distribution of the tax burden between different objects and taxable persons. Tax policy has a strong impact on the development of a country, since tax revenue is the most important source of income for countries. It is important to follow the principles of fairness and efficiency: taxpayers should not be overburdened by taxes, but the state should be able to fulfil its primary functions.

The raising of excise duty rates has had a positive impact on the consumption of alcoholic beverages and tobacco products in Estonia: their consumption has decreased, which fulfils one of the main purposes of excise duty rates. The Government should continue to raise tax rates in

the future and already has plans to do this. However, there are some risks here, for example, the sales of illegal goods could increase and the state could lose tax revenue. It is also important to monitor the alcohol and tobacco policy of the neighbouring countries. Given the opportunity, people will go and buy cheaper products across the border. A major risk is associated with Russia and the Estonian–Russian border in Narva. It is the job of the Estonian Tax and Customs Board and the police to track and limit the movement of illegal goods, and this can be regulated on the national level. Illegal trade has always existed and is likely to exist in the future, because it is impossible to control everything. Tax rates will be raised in the future and will cause several problems. The prices of alcoholic beverages and tobacco products should not rise faster or slower than average wages. On the other hand, the excise duty rates should be raised closer to the rates in nearby countries, especially Finland. Estonia cannot always compare itself to the Nordic countries, but it is important to adopt solutions that have proved successful as well as learn from the mistakes of other countries.