




# Tobacco taxation policy in Slovenia

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## Abstract

In 2012, Slovenia changed its structure of the cigarette excise tax, greatly increasing the specific excise rate, but decreasing the ad valorem excise rate. The reform was very beneficial for public health as it increased the price of the cheapest cigarettes disproportionately and thus decreased tobacco consumption within the country (by 20% in 2012–2014), and limited switching down to cheaper cigarettes and cigarette outflow out of the country. However, the ad valorem excise decrease seems to be exorbitant, and it was one of the causes that tobacco excise revenue did not increase in 2012–2015. Countries with mixed tobacco excise systems should be careful in changing their excise structure. While a large increase in the specific excise rate is the most beneficial change regarding health, ad valorem rates do not necessarily need to be reduced. Slovenia has a great opportunity to increase tobacco excise rates next year, which will be beneficial for both public health and governmental revenue.



TAXATION

TOBACCO TOBACCO  
INDUSTRY

SMOKING

HEALTH  
POLICY





## Contents

Introduction	6
Data sources	7
Results	8
Tobacco taxation changes in 2002–2016	8
Cigarette prices	9
Tobacco affordability	10
Tobacco sales	12
Tobacco excise revenue	13
Discussion	15
Conclusions	17
References	18



# Introduction

In 2005, Slovenia ratified the WHO Framework Convention on Tobacco Control (WHO FCTC) (1), and the country has committed itself to the implementation of the cross-sectoral measures outlined in the Convention to protect people from tobacco use.

The WHO FCTC includes Article 6 entitled “Price and tax measures to reduce the demand for tobacco”. The Parties to the Convention recognize that price and tax measures are an effective and important means of reducing tobacco consumption in various segments of the population, in particular in young people. Each Party should implement tax policies and price policies on tobacco products so as to contribute to the health objectives aimed at reducing tobacco consumption. In 2014, the Conference of Parties adopted Guidelines for implementation of Article 6 of the WHO FCTC (2).

In May 2004, Slovenia joined the European Union (EU) and thus had to meet all requirements of the relevant EU directives on tobacco taxation.

This publication aims to

- estimate the impact of tobacco taxation policy on tobacco consumption and tobacco excise revenues in Slovenia between 2002 and 2016; and
- propose options for tobacco taxation policies to be implemented in 2017 taking into account their impact on tobacco consumption and revenues.



## Data sources

Data on tobacco excise rates, weighted average prices (WAPs), revenues and other indices were taken from the European Commission database (3). Data on cigarette prices and other indices were taken from the website of the Statistical Office of the Republic of Slovenia (4). Some additional data were taken from the Eurostat database (5).



# Results

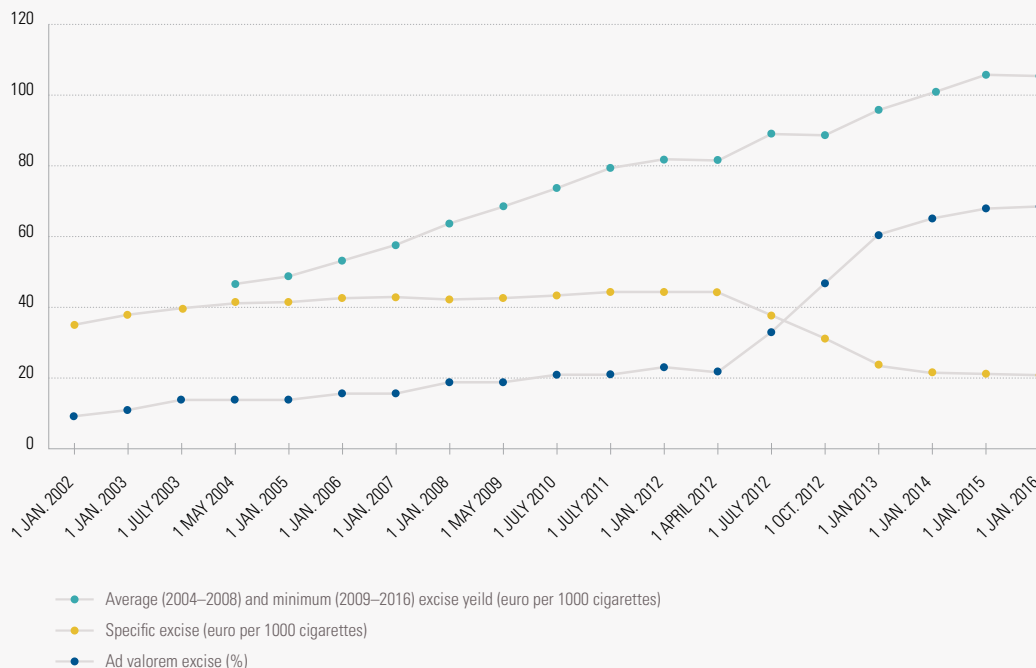
## Tobacco taxation changes in 2002–2016

Since 2002, excise rates for cigarettes in Slovenia have changed annually (Fig. 1). The specific excise rate was increased eight-fold from 8.5 to 68.83 euro per 1000 cigarettes between 2002 and 2016. Between 2002 and 2012, the ad valorem excise rate was increased from 35.87% to 45.63%, before it was reduced to 21.18%.

For fine-cut tobacco, only a specific excise tax was used until 2014. In 2004–2009, the specific rate was increased from 32 to 35 euro per kilogram. Then it was increased to €40/kg in 2010, €45/kg in 2012 and €67.5/kg in 2013. In 2014, the specific rate was decreased to €40/kg, but a 35% ad valorem excise was introduced for fine-cut tobacco.

The most dramatic changes in excise rates in Slovenia were undertaken in several steps in 2012: the specific rate was increased almost three-fold from 21.88 to 60.79 euro per 1000 cigarettes, while the ad valorem rate was cut by almost half from 45.63% to 24.55% (Fig. 1).





**FIG 1.**  
Excise tax rates for cigarettes in Slovenia, 2002–2016

Source: European Commission (3).

Slovenia has met the EU requirements on minimum excise tax rates: in 2008, the excise reached 64 euro per 1000 cigarettes and, in 2012, 90 euro per 1000 cigarettes.

In July 2013, the value-added tax (VAT) rate in Slovenia was increased from 20% to 22%.

## Cigarette prices

Between 2003 and 2015, cigarette prices increased more than inflation for all years (except 2008) for all three brands monitored by the Statistical Office of the Republic of Slovenia (Table 1).

Year	Extra 91		West		Marlboro		Consumer price indices, all items, yearly average (%)
	Price (€/ pack of 20 cigarettes)	Price increase (%)	Price (€/ pack of 20 cigarettes)	Price increase (%)	Price (€/ pack of 20 cigarettes)	Price increase (%)	
2003	1.44	–	1.65	–	1.92	1.92	–
2004	1.62	12.5	1.77	7.3	2.07	2.07	3.6
2005	1.73	6.8	1.90	7.3	2.19	2.19	2.5
2006	1.85	6.9	2.02	6.3	2.32	2.32	2.5
2007	2.00	8.1	2.17	7.4	2.53	2.53	3.6
2008	2.10	5.0	2.20	1.4	2.60	2.60	5.7
2009	2.23	6.2	2.30	4.5	2.73	2.73	0.9
2010	2.45	9.9	2.50	8.7	3.03	3.03	1.8
2011	2.61	6.5	2.70	8.0	3.20	3.20	1.8
2012	2.88	10.3	2.98	10.4	3.38	3.38	2.6
2013	3.15	9.4	3.25	9.1	3.65	3.65	1.8
2014	3.30	4.8	3.40	4.6	3.82	3.82	0.2
2015	3.40	3.0	3.50	2.9	3.90	3.90	–0.5

**TABLE 1.**  
Average annual prices of and price increases on cigarettes in Slovenia, 2003–2015

Source: Statistical Office of the Republic of Slovenia (6).

According to data from the European Commission database (3), the excise tax share of the retail price of the most popular price category in 2004–2010 only increased from 57% to 59%, which means that the tobacco industry increased its (net-of-tax) part of the price almost in parallel with the excise increases. In 2011, Slovenia introduced the WAP category, consistent with EU policy. The excise share in the WAP first increased from 60.6% to 65.8% between 2011 and 2013, as excise yield increased, but the industry kept its part of the price (profit margins) unchanged. Between 2013 and 2016, the excise share decreased from 65.8% to 60.4%, as the excise tax was increased from 97 to 106 (or by 9) euro per 1000 cigarettes, while the industry's profit margin in the WAP increased from 25 to 38 (or by 13) euro per 1000 cigarettes. Eventually the cigarette price (WAP) increased from 2.95 (in 2013) to 3.51 (in 2016) euro per pack (by 19%). This price increase reduced the affordability of tobacco with a subsequent decline in tobacco consumption.

## Tobacco affordability

According to the Guidelines for implementation of Article 6 of the WHO FCTC (2), “Tax rates should be monitored, increased or adjusted on a regular basis, potentially annually, taking into account inflation and income growth developments in order to reduce consumption of tobacco products.”

Slovenia increased its tax rates even more often than annually, but the impact of these increases on tobacco consumption depends on inflation and income growth.

For the period of 2003–2015, tobacco prices increased more than the inflation rate except in 2008 (Fig. 2). However, the price growth of tobacco products in 2015 was moderate. Changes in average tobacco prices are determined not only by tobacco excise rates, but also by changes in the cigarette market (when more expensive cigarettes gradually replace cheap cigarettes, the average price increases) and the price policy of cigarette importers.

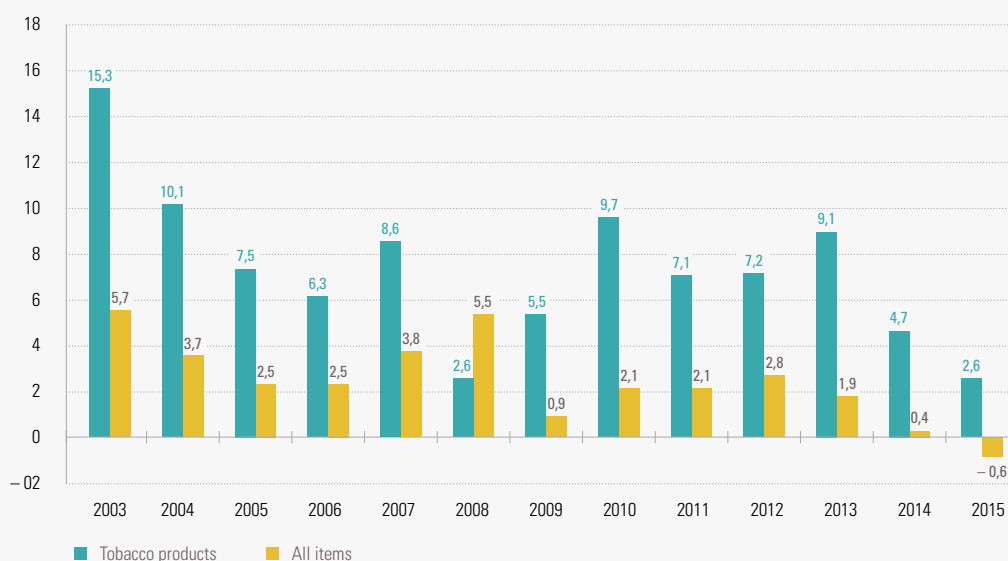


FIG 2. Harmonized index of consumer price (HICP) for all items and tobacco products, 2003–2015

Source: Eurostat (7).

The increases in tobacco prices were substantially above the inflation rate. This should lead to a reduction in the consumption of tobacco products. However, such reductions are only possible if the tax increases lead to price increases and tobacco products become less affordable.

The Guidelines for implementation of Article 6 of the WHO FCTC (2) recommend: “When establishing or increasing their national levels of taxation Parties should take into account – among other things – ... changes in household income, to make tobacco products less affordable over time in order to reduce consumption and prevalence”. In the Guidelines, “affordability” means price relative to per capita income.

In the current analysis, a modified tobacco affordability index (TAI) (8) is used to estimate the changes in tobacco affordability in 2007–2015. TAI is calculated as the percentage annual change in disposable income per capita divided by the tobacco price increase:  $TAI = (\text{income increase}/\text{consumer price index tobacco} - 1) * 100$ . A negative TAI value means that tobacco became less affordable, and tobacco consumption is expected to decrease. Calculations of TAI in Slovenia are presented in Table 2. As the data for disposable income per capita are not available, proxies are used to estimate income changes.

- TAI 1 uses household and non-profit institutions serving households final consumption expenditure per capita (chain-linked volumes, percentage change over previous period) data from Eurostat (9).
- TAI 2 uses gross domestic product (GDP) per capita (in euros) at current prices and at current exchange rate data from the Statistical Office (10).

Year	HICP tobacco products <sup>a</sup>	Household consumption expenditure change (previous year = 100) <sup>b</sup>	TAI 1	GDP per capita change (previous year=100) <sup>c</sup>	TAI 2
2003	115.3	103.4	-10.3	105.1	-8.8
2004	110.1	102.9	-6.5	105.4	-4.2
2005	107.5	102	-5.1	105.1	-2.2
2006	106.3	100.9	-5.1	107.6	1.2
2007	108.6	105.8	-2.6	110.8	2
2008	102.6	102.2	-0.4	107.8	5.1
2009	105.5	99.9	-5.3	94.4	-10.5
2010	109.7	100.6	-8.3	99.9	-8.9
2011	107.1	99.8	-6.8	101.6	-5.2
2012	107.2	97.3	-9.2	97.4	-9.2
2013	109.1	95.8	-12.2	99.6	-8.7
2014	104.7	100.6	-3.9	103.8	-0.9
2015	102.6	101.7	-0.9	103.2	0.6

**TABLE 1.**  
**Average annual prices of and price increases on cigarettes in Slovenia, 2003–2015**

<sup>a</sup> HICP data come from Eurostat (7).

<sup>b</sup> Data from Eurostat (9).

<sup>c</sup> Data from the Statistical Office of the Republic of Slovenia (10).

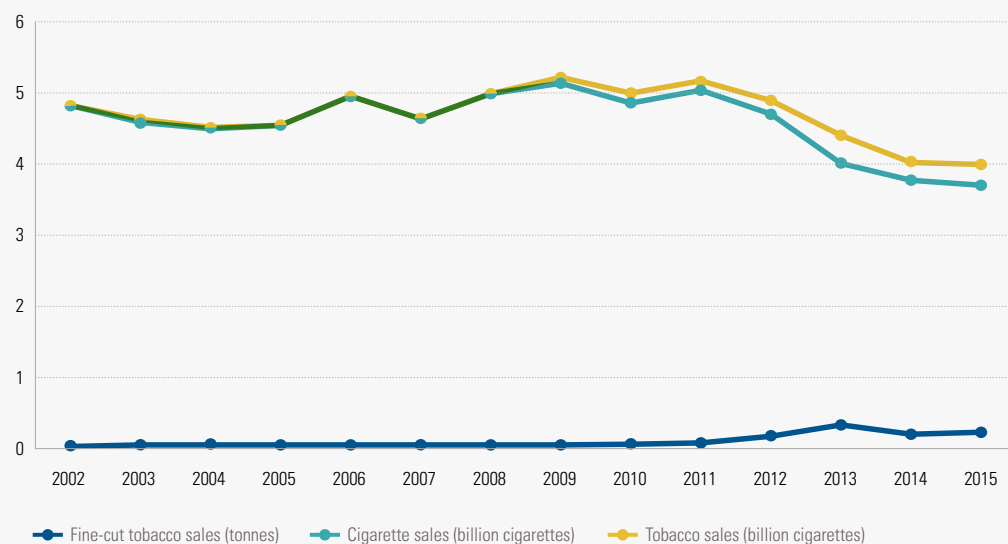
Both TAI estimates produced similar trends in tobacco affordability in Slovenia.

- In 2003–2005 affordability declined.
- In 2006–2008 it increased.
- The large decline in tobacco affordability was observed in 2009–2013 when it was high enough to encourage a reduction in tobacco consumption.

However, changes in tobacco consumption are not always reflected by changes in cigarette sales, as sales volumes also depend on the trends of unregistered cigarette flows both into and out of the country. Some flows could be legal (when travellers buy cigarettes in one country paying all taxes and then take these cigarettes within legal limits to smoke in another country); others involve illicit trade, which the FCTC defines as “any practice or conduct prohibited by law and which relates to production, shipment, receipt, possession, distribution, sale or purchase” (1).

## Tobacco sales

All cigarettes sold in Slovenia are imported. Cigarettes constituted 99% of tobacco sales in Slovenia between 2002 and 2011. In 2012–2013, sales of fine-cut tobacco increased substantially, possibly due to the large difference in the excise tax rate between cigarettes and fine-cut tobacco. Gallus et al. estimate the median weight of one roll-your-own cigarette to be 0.75 g (11), which this publication also uses. In 2002–2004, recorded tobacco sales in Slovenia initially declined to 4.5 billion cigarettes before reaching 5 billion cigarettes in 2008 (Fig. 3). In 2008–2011, tobacco sales were mostly stable, but then declined from 5 to 4 billion cigarettes between 2012 and 2014.



**FIG 3.**  
Tobacco sales in Slovenia, 2002–2015<sup>a</sup>

<sup>a</sup> Tobacco sales expressed in cigarettes assumes a median weight of 0.75 g per roll-your-own cigarette (11).

Source: European Commission (3).

The tobacco industry usually claims that any decline in cigarette revenues is caused by an increase in cigarette smuggling. For example, British American Tobacco (12) claimed: “In some developed countries we have seen tax rates raised to such a high level that tax



revenue begins to fall, as smokers seek out cheaper, black market alternatives.” However, data for Slovenia contradict such claims. The KPMG studies (projects Star and Sun (13)), commissioned by Philip Morris International and other tobacco corporations, estimated both the outflow (cigarettes sold and taxed in Slovenia, but smoked in other countries) and non-domestic consumption and inflow (including contraband, counterfeit into the country and cigarettes brought from abroad within legal limits).

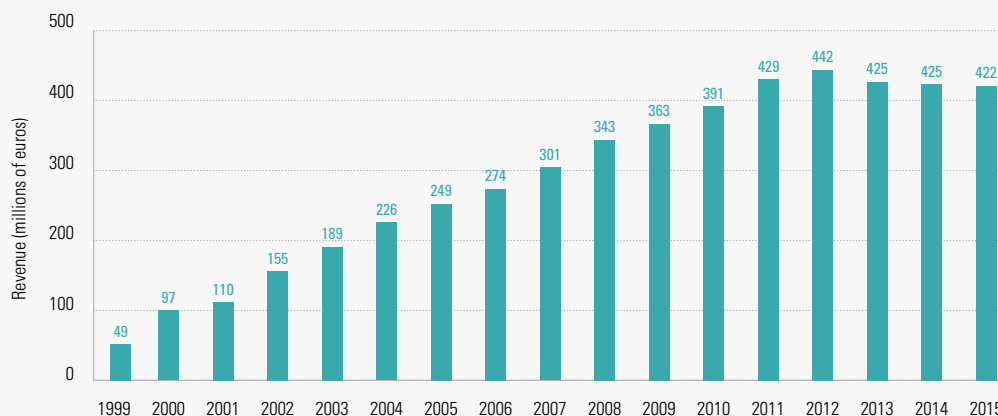
KPMG estimates showed the following.

- Total (licit and illicit) cigarette consumption increased in Slovenia in 2006–2008 and then declined by 38% or by 1.8 billion cigarettes in 2008–2014, before increasing slightly in 2015.
- Every year, cigarette outflows from Slovenia exceeded cigarette inflows (brought into the market by consumers within legal limits, and contraband and counterfeit products) into Slovenia.
- Cigarette outflows from Slovenia increased in 2006–2011 and then declined by 45% by 2015.
- Cigarette inflows into Slovenia (licit and illicit consumption) increased in 2006–2008, then declined by a factor of 2.5 in 2008–2010 and later stabilized at about 0.3 billion cigarettes a year.

Illicit cigarette consumption, as a percentage of total consumption, increased from 5.4% in 2010 to 7.7% in 2014; this could give the impression that smuggling increased. However, the original KPMG data revealed that the number of contraband and counterfeit cigarette sales in Slovenia did not increase over those years, and the apparent increase in illicit consumption was only caused by the decline in legal cigarette sales (see Fig.3).

## Tobacco excise revenue

Tobacco excise revenues in Slovenia increased nine-fold between 1999 and 2012 (Fig. 4). Then they declined slightly in 2013 and were stable afterward, despite increases in excise rates (see Fig.1).



**Fig. 4.**  
Tobacco (cigarettes and other tobacco products) excise revenues in Slovenia, 1999–2015

Source: European Commission (3).

Several possible factors may account for the tobacco excise revenue decline in 2013–2015.

- 01— First, the large reduction in tobacco consumption in Slovenia may be due to the large decline in tobacco affordability in 2012–2013 and the reduction in incomes (see Table 2).
- 02— Second, the VAT rate increased in 2013, which added to cigarette tax and price increases and the subsequent reduction in tobacco consumption. As a result, VAT revenue increased, but excise revenue decreased.
- 03— Third, fine-cut tobacco sales increased in 2012–2013, since excise rates were much lower on fine-cut tobacco than on cigarettes.
- 04— Fourth, the tobacco excise reform of 2012 greatly increased the specific excise rate while decreasing the ad valorem rate (see Fig.1). This resulted in making cheap cigarette brands relatively more expensive (see Table 1) and discouraged both tobacco consumption within the country and cigarette outflows from Slovenia, since the price of cheaper cigarettes increased disproportionately to that of more expensive brands, and thus the volumes of taxable cigarettes declined.
- 05— Fifth, as the ad valorem excise rate was substantially reduced, the tobacco industry could increase profits by increasing the industry's part of the price (the wholesale or profit margin). Between 2013 and 2016, the industry's profit margin in the WAP increased from 25 to 38 euro per 1000 cigarettes or by 50%, which was much higher than the excise increase and inflation. The higher increase in final retail prices also resulted in reduced cigarette consumption and smaller volumes of taxable cigarettes. Thus the industry increased its profits as profit margins per pack increased much more than sales declined (see Fig.3) while governmental revenues stagnated.

## Discussion

Over the observed period, five types of tobacco excise policy were practised in Slovenia.

2002—  
2004

In 2002–2004, excise rates were increased substantially just before joining the EU. Subsequently, tobacco affordability declined and tobacco sales decreased, while revenues increased. This was a classical win-win taxation policy because the excise tax increase was high enough to reduce tobacco consumption.

2005—  
2008

In 2005–2008, the increase in excise rates was moderate and, as incomes grew, tobacco affordability increased, as well as tobacco consumption. Joining the EU opened the country's borders, and cigarette outflows to EU countries also increased. All these factors increased the volume of taxable cigarettes by 10% in 2005–2008 and, while the average excise yield (calculated as annual tobacco revenue/annual tobacco sales) increased only by 36%, tobacco revenue increased by 52%. That policy had clear fiscal benefits, but no public health benefits as it encouraged tobacco consumption both in Slovenia and in neighbouring counties.

2009—  
2010

In 2009–2011, excise rates increased, but tobacco sales were stable, possibly due to the decline in cigarette inflows into Slovenia from Bosnia and Herzegovina (14) during the economic recession, while outflows from Slovenia continued to increase. Tobacco consumption in Slovenia declined, but slowly. Tobacco revenue increased by 25% in line with average excise rate increases. This policy was beneficial from a fiscal perspective, but public health benefits were rather small.

2012—  
2014

In 2012–2014, the tobacco excise reform of 2012, which notably increased the specific excise rate and decreased the ad valorem rate (see Fig. 1), was very beneficial from a public health perspective. It both greatly reduced tobacco affordability in Slovenia (see Table 2) and discouraged outflows from Slovenia. The total reduction in tobacco sales in Slovenia was about one billion cigarettes (see Fig. 3), and there is no evidence that this reduction in sales was even partly compensated by black market alternatives. However, the increase in average excise yields was too low to compensate for the decline in taxable sales. Other factors such as population income decline, VAT increase, an increase in the industry's (net-of-tax) part of the price, and increases in the sales of fine-cut tobacco also contributed to the reduction in tobacco consumption and excise revenue. The large increases in the excise burden for fine-cut

2015—  
2016

tobacco, introduced in 2013 and 2014, decreased fine-cut tobacco sales (see Fig. 3), which also contributed to the stabilization of excise revenues.

In 2015–2016, the average excise yield was increased by only 2% in 2015. Cigarette prices increased by 2.6%, as the industry increased its part of the price more than the growth in excises. In 2016, the minimum excise rate remained at the same level as in 2015; the specific excise rate was increased by 0.6%, while the ad valorem excise rate was decreased by 4% (15). The actual excise portion of the price decreased. For example, for cigarettes priced at 3.9 euro per pack, the excise yield decreased from 2.23 to 2.20 euro per pack. This policy will neither decrease the tobacco consumption nor increase tobacco excise revenue.

Slovenia has the sovereign right to determine and establish its taxation policies, including the level of tax rates to apply, and the structure and system of tobacco taxes, taking into account national circumstances to achieve public health, fiscal and other objectives.

A simple tax model illustrates the relationship between increased excise tax rates and decreased consumption. If Slovenia increased its average excise rate by 25% to 132 euro per 1000 cigarettes in 2017, its excise rate would be equal to that of its neighbouring EU countries (Austria and Italy). It would increase the excise tax by 0.5 euro per cigarette pack, and the WAP would increase from 3.51 to 4.05 euro per pack or by 20%. The WAP would still be lower in Slovenia than in Austria (€4.33) and Italy (€4.52). Experience has shown that such moderate increases in excise rates did not increase the inflow of non-taxed cigarette into Slovenia very much. Even if such a tax increase would decrease tobacco sales in 2017 by 10% (from 4 to 3.6 billion cigarettes), it would still bring in 475 million euro ( $€0.132 * 3.6$  billion cigarettes) in tobacco excise revenues; the current excise taxation policy is only able to keep revenue at the annual level of 424 million euro ( $€0.106 * 4$  billion cigarettes), as in 2014 and 2015. This proposed tax increase would both increase tobacco revenue and decrease tobacco consumption, and mark a return to a win-win policy.



## Conclusions

Tobacco taxation policy in Slovenia in 2012–2014 was very successful from a public health perspective as it contributed to the health objectives aimed at reducing tobacco consumption, in line with the FCTC obligations. In those years estimated tobacco consumption within the country declined by 20%. The outflow of cigarettes taxed in Slovenia to other countries also declined, while the inflow of cigarettes, which were not taxed in Slovenia, did not increase.

However, the policy did not increase tobacco excise revenue in 2012–2015, while revenue increased nine-fold between 1999 and 2012. The recent stagnation in revenue growth was caused by the fact that the increase in tobacco excise yield had the same magnitude as the reduction in tobacco consumption. While the excise taxation policy was the main factor in this reduction, it was also reinforced by a combination of several other factors: a VAT rate increase, decline in population incomes, increases in the tobacco industry's (net-of-tax) part of the price, etc.

When cigarettes and other tobacco products become less affordable, tobacco consumption in the country virtually always declines. Three main factors can change tobacco affordability:

- tobacco taxes
- tobacco industry's (net-of-tax) prices (margins)
- population incomes and inflation.

When affordability declines only due to the last two factors, tobacco tax revenues will also decline as volumes of taxable products decrease. In such a situation, the tobacco tax hike should be high enough to ensure that tobacco revenue increases when tobacco sales decrease, as in many other countries such as Ukraine (16).

In 2012, Slovenia changed its structure of the cigarette excise tax, greatly increasing the specific excise rate, but decreasing the ad valorem excise rate. The reform was very beneficial for public health as it increased the price of the cheapest cigarettes disproportionately and thus decreased both tobacco consumption within the country, and limited switching down to cheaper cigarettes and cigarette outflow out of the country. However, the ad valorem excise decrease seems to be exorbitant, and it was one of the causes of the revenue decline in 2013. Countries with mixed tobacco excise systems should be careful in changing its excise tax structure. While a large increase in the specific excise rate is the most beneficial change in terms of limiting switching to cheaper brands and health, ad valorem rates do not necessarily need to be reduced.

Slovenia has a great opportunity to increase tobacco excise rates, which will be beneficial for both public health and governmental revenue.

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