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## THE LEGAL FRAMEWORK AFFECTING SMUGGLING OF TOBACCO PRODUCTS AS A FORM OF THE SHADOW ECONOMY IN SAKARTVELO<sup>1</sup>

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The purpose of this article is to research the legal framework affecting smuggling of tobacco products in Sakartvelo. To fulfil the defined purpose, the following objectives were raised: to review the theoretical aspects of smuggling as a form of the shadow economy and research the legal framework for tobacco control in Sakartvelo. Sakartvelo is an example of a country that, due to ongoing progressive economic reforms and the establishment of the Revenue and Customs Supervision Service, managed to successfully control the illegal market of tobacco products. In a relatively short period of time, Sakartvelo was able to reduce the level of corruption, implement an effective system of tax administration and supervision, and introduce a strict border control system. Tobacco control is a significant aspect of Sakartvelo's EU integration. According to the Association Agreement between the EU and Sakartvelo concluded in 2014, one of Sakartvelo's obligations under this agreement is the effective application of international agreements, recognized by the EU member states in the area of health care. Sakartvelo's legal framework is supported by at least 85 percent of the population, and law abidance rate amounts to 98 percent.

**Key words:** smuggling of tobacco products, shadow economy, legal regulation, Sakartvelo.

### Tabakas izstrādājumu kontrabandas kā ēnu ekonomikas veida ierobežošanas un novēršanas tiesiskais regulējums Sakartvelo

Raksta mērķis ir izpētīt tiesisko regulējumu tabakas izstrādājumu kontrabandas ierobežošanā un apkarošanā Sakartvelo. Minētā mērķa īstenošanai tiek izvirzīti sekojoši uzdevumi: apskatīt kontrabandas kā vienas no ēnu ekonomikas formām teorētiskos aspektus un piedāvāt tabakas izstrādājumu aprites kontroles normatīvā regulējuma pilnveidošanas pasākumus Sakartvelo. Sakartvelo var kalpot par piemēru tam, kā progresīvas ekonomiskās reformas un Nodokļu un muitas uzraudzības dienesta nostiprināšana ļauj sekmīgi kontrolēt tabakas izstrādājumu nelegālo tirgu. Relatīvi īsā laika periodā Sakartvelo spēja samazināt korupcijas līmeni, ieviest efektīvu nodokļu un nodevu administrēšanu un uzraudzību, kā arī ieviest stingru robežkontroles sistēmu. Tabakas izstrādājumu aprites kontrole ir būtisks aspekts Sakartvelo integrācijai Eiropas Savienībā. Saskaņā ar 2014. gadā noslēgto Eiropas Savienības un Sakartvelo Sadarbības līgumu viena no būtiskākajām Sakartvelo saistībām ir efektīvizēt starptautisko līgumu izpildi veselības

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<sup>1</sup> Sakartvelo is native term of Georgia since 1995. It is a state of Cartveli (native term of Georgians). The term э 'Georgia' was introduced by ancient Greeks, but the term Грузия was introduced by zarist Russia.

aprūpes jomā, kas ir saistoši visām Eiropas Savienības dalībvalstīm. Būtu jāatzīmē, ka Sakartvelo izstrādāto normatīvo regulējumu tabakas izstrādājumu aprites kontroles jomā atbalsta ne mazāk kā 85 procenti tās iedzīvotāju un 98 procenti iedzīvotāju ir neiecietīgi pret jebkāda veida tiesībpārkāpumiem pētāmajā jomā.

**Atslēgvārdi:** tabakas izstrādājumu kontrabanda, ēnu ekonomika, tiesiskais regulējums, Sakartvelo.

### **Правовое регулирование ограничения контрабанды табачных изделий как одной из форм теневой экономики в Сакартвело**

Целью данной статьи является изучение правового регулирования ограничения контрабанды табачных изделий в Сакартвело. Для достижения поставленной цели выдвинуты следующие задачи: рассмотреть теоретические аспекты контрабанды табачных изделий, как одной из форм теневой экономики, и предложить меры по совершенствованию нормативного регулирования оборота табачных изделий в Сакартвело. Сакартвело может служить примером того, как прогрессивные экономические реформы и работа Службы по надзору за сбором налогов и таможей позволяют успешно контролировать нелегальный рынок табачных изделий. В течение условно короткого времени Сакартвело смогло уменьшить уровень коррупции, наладить эффективное администрирование и контроль за сбором налогов, а также создать строгую систему пограничного контроля. Контроль за оборотом табачных изделий является существенным аспектом интеграции Сакартвело в Европейский Союз. В соответствии с заключённым в 2014 году Договором о сотрудничестве между Европейским Союзом и Сакартвело одним из наиболее значимых обязательств Сакартвело является повышение эффективности выполнения международных договоров в области здравоохранения, которые являются обязательными для всех стран-участниц Европейского Союза. Весьма существенным является тот факт, что разработанное в Сакартвело нормативное регулирование по контролю за оборотом табачных изделий одобряет не менее 85 процентов её населения, а 98 процентов населения проявляет нетерпимость к любому рода правонарушениям в данной сфере.

**Ключевые слова:** контрабанда табачных изделий, теневая экономика, правовое регулирование, Сакартвело.

## **Introduction**

Smuggling refers to illegal transportation of certain items or things across national borders by evading customs control when above-mentioned items or things are transported to illegally satisfy the demand for prohibited or highly taxed goods or services. The major macroeconomic determinants of smuggling include regional and international economic integration, globalization, international trade barriers and their reduction, and inflation; the major taxation-related determinants cover taxes applied to goods and the general tax burden; the major legal determinants are strength (weakness) of the legal framework and border control (in)efficiency; the major institutional determinants comprise corruption and the quality of public institutions; the major social determinants encompass income inequality and poor protection of human rights; the major maSakartvelorket determinants involve consumer demand and retail price of products.

In the World Bank Group's (2019) report "Confronting Illicit Tobacco Trade: A Global Overview of Country Experiences", Sakartvelo represents a successful example of the fight against the illicit tobacco trade because the country succeeded in reducing

the amount of illegal tobacco products in its domestic market through raising tobacco taxes and implementing the 2014 EU-Georgia Association Agreement. The biggest risk of large-scale illegal trade in Sakartvelo is related to the export/import business, as Sakartvelo plays an important role as a transit country for illegal tobacco products. Small-scale smuggling is not a problem because tobacco products prices in Sakartvelo follow roughly the same trend as the neighbouring countries, except for Turkey, where taxes and prices are much higher.

Sakartvelo is an example of a country that, due to ongoing progressive economic reforms and the establishment of the Revenue and Customs Supervision Service, managed to successfully control the illegal market of tobacco products. In a relatively short period of time, Sakartvelo was able to reduce the level of corruption, implement an effective system of tax administration and supervision, and introduce a strict border control system. The above-mentioned components contributed to a successful fight against the illegal trade in tobacco products. By applying various administrative measures and at the same time carrying out a continuous policy of raising the excise tax on cigarettes, Sakartvelo managed to significantly reduce the level of tax evasion.

The highest levels of tax evasion in the country were recorded between 1997 and 2003, when excise tax rates on imported and domestic cigarettes were approximately 4–8 times lower than in 2017. However, even in 2017 the market for illegal cigarettes shrank very little. This confirms that the role of tobacco products taxes as a driving force for illicit tobacco products trade is relatively small. Nevertheless, Sakartvelo's experience shows that raising tobacco taxes can increase budget revenue, even if there is strict control over the illegal trade in tobacco products.

The critical issues which Sakartvelo's government will have to address in the future are the weak control of the borders with Russian-occupied Abkhazia and South Ossetia, the illegal movement of goods across the border with Armenia, and the potential movement of illegal goods through Sakartvelo's territory to other countries. Ratification of the Illicit Trade Protocol would provide more tools to address these loopholes in the system. In 2017, after a sharp rise of the excise tax, the budget income increased, and the affordability of cigarettes decreased. Moderate increases in excise duty in recent years have been beneficial from a revenue perspective, but have had less of a positive impact on public health. The excise tax on tobacco products, and especially on unfiltered cigarettes, is, however, still low compared to Sakartvelo's neighbour Turkey or the EU. The excise tax was intended to be increased in January 2018, but the country's government focused on adopting a strict tobacco control law in May of the same year, so the tax increase was postponed. This decision may also have been affected by the pressure exerted by representatives of the tobacco industry, as their influence on government agencies and officials is noticeable. Nevertheless, the country needs to raise the rates of excise tax on tobacco products since affordability of cigarettes increased between 2010 and 2017.

The major purpose of this article is to research the legal framework affecting smuggling of tobacco products in Sakartvelo. To fulfil this purpose, the following objectives were raised: to review the theoretical aspects of smuggling as a form of the shadow economy and research the legal framework for tobacco control in Sakartvelo. Research methods: scientific literature analysis, analysis of legal documents.

## Theoretical aspects of smuggling

Smuggling is one of the forms of illegal concealment of income that is not paid to the state budget. It is mostly associated with illegal transportation of particular objects or things across the state border by evading customs control (Čolakovič 2016). Joossens and Raw (2012) define smuggling as the illegal trade of certain goods or services across national borders. Smuggling occurs when traders seek to illegally meet the demand for certain goods or services, usually those that are prohibited (e.g. drugs, psychotropic substances) or heavily taxed (e.g. tobacco, alcohol products).

Literature indicates many different types of smuggling, which can be grouped as follows:

- smuggling by volume;
- smuggling by transported items;
- smuggling by the type of offence.

The above-presented grouping is based on the studies by Burke (2013), Thursby and Thursby (2000), Cohen with his colleagues (2001), Goel (2008), LaFaive and Nesbit (2013), Benson and Decker (2010), Čolakovič (2016) and other researchers. This grouping is not exhaustive, but considers obviousness of the essential criteria of smuggling (volume, transported items and the type of offense) in practice.

As a complex phenomenon, smuggling is determined by many factors. After analysing the literature, the major determinants of smuggling are categorised in Table 1.

Table 1  
Categorization of the major determinants of smuggling

Category	Determinants	Sources
Macroeconomic determinants	Regional and international economic integration, globalization, reduction of international trade barriers, trade restrictions, burden of trade tariffs, inflation	Javorcik, Narciso 2008; Jean, Mitari-tonna 2010; Buehn, Farzenegan 2012; Golub 2012; Bouet, Roy 2012; Hoda, Mansoor 2015; Smart 2015; Benassi et al. 2016; Martsiushevskaya, Ostroga 2017
Tax determinants	Taxes on goods, excise duty, general tax burden	Burke 2013; Hoda, Mansoor 2015; Benassi et al. 2016
Legal determinants	Strength of the legal framework, (in)efficiency of border control provisions	Buehn, Farzenegan 2012; Golub 2012
Institutional determinants	Corruption, institutional quality	Buehn, Farzenegan 2012
Social determinants	Income inequality, poor protection of women's rights	Jac-Kucharski 2012
Market determinants	Consumer demand, retail price of products	Saba et al. 1995; Golub, Mbaye 2009; Golub 2012

Source: compiled by the authors.

Table 1 shows that the major determinants of smuggling can be categorised as macroeconomic, tax, legal, institutional, social and market-related.

When researching *macroeconomic determinants*, Martsiushevskaya and Ostroga (2017) note that the processes of economic integration and globalization taking place at the international and regional levels, as well as reduction of international trade barriers lead to the gradual transformation of the global space into a unified economic zone where capital, goods and services move practically freely, which creates favourable conditions for smuggling. Buehn and Farzenegan (2012) confirm the effects of trade restrictions and trade tariffs, while Hoda and Mansoor (2015) focus on the impact of inflation. Javorcik and Narciso (2008), Jean and Mitaritonna (2010), Bouet and Roy (2012) and other researchers confirm the assumption proposing that if the level of export in the country of origin exceeds the level of import in the country of destination, the conditions favourable for smuggling are created. Smart (2015) argues that strict import and export restrictions create an environment for generating the informal flows of benefits in the social, economic and political context.

In the category of tax determinants, Benassi and his colleagues (2016) confirm that charging higher taxes on goods explains the choice of conducting informal trade, and this determinant is more important than international trade policies because it tends to raise probability of informal trade. Burke (2013) substantiates the impact of excise tax, while Hoda and Mansoor (2015) suggest that the overall tax burden is a statistically significant determinant of smuggling.

In the category of *legal determinants*, Buehn and Farzenegan (2012) researched the volume of smuggling in 55 countries between 1990 and 2000. The authors applied the Multiple Indicators and Multiple Causes (MIMIC) model, in which smuggling was considered as a hidden (latent) variable. They found that the strength (weakness) of a country's legal framework has a statistically significant impact on smuggling. Golub's (2012) study revealed the significance of the (in)efficiency of border control regulations.

In the category of *institutional determinants*, there is a relationship between smuggling and corruption rooted in public institutions (Buehn, Farzenegan 2012). Fisman and Wei (2015) associate high levels of corruption with smuggling of cultural objects from the country of origin.

To identify the major social determinants, Jac-Kucharski (2012) applied a negative binomial regression model and found that income inequality and poor protection of women's rights stimulate smuggling in terms of human smuggling as it helps to create a large pool of potential victims, which reduces the operational costs of smugglers.

In the category of market determinants, the impact of consumer demand is emphasized: high consumer demand tends to raise the prices of smuggled goods as well as profits of persons engaged in this activity (Saba et al. 1995). Golub and Mbaye (2009) and Golub (2012) also indicate the significance of the difference in the retail price of products in the country of origin and the country of destination.

## The tobacco control legal framework in Sakartvelo

In 2017, the Ministry of Internally Displaced Persons from the Occupied Territories, Labour, Health and Social Affairs of Sakartvelo (hereinafter – the Ministry), in close cooperation with the National Centre for Disease Control and Public Health (NCDC) and other government agencies, the United Nations Development Program, the agencies implementing the WHO Framework Convention on Tobacco Control, and the World Health Organization conducted the first economic study related to the tobacco control policies – the co-called Investment Case research, which revealed the detrimental effects of tobacco on population's health and economy, allowed to assess the objectives of the tobacco control intervention for sustainable development in the context of saving the state budget funds and preventing tobacco-caused diseases and premature mortality, and estimated the costs of inaction in the area under consideration. The research revealed that about 11,400 people in Sakartvelo die every year from tobacco-related diseases; every fifth person is a passive smoker. The annual economic costs related to tobacco in Sakartvelo amount to GEL 824.9 million, i.e. 2.43 percent of GDP.

The four priority areas of the tobacco control intervention within the WHO Framework Convention on Tobacco Control are as follows:

1. taxation of tobacco products;
2. complete ban on smoking in public places;
3. complete prohibition of advertising, promoting and sponsoring the sale of tobacco products;
4. packaging and labelling of tobacco products.

The above-mentioned interventions are estimated to prevent 53,100 deaths over 15 years and reduce total tobacco-related economic costs to GEL 3.6 billion by 2033.

On 1 May 2018 Sakartvelo started the campaign “Against smoking” which helped to achieve almost all main strategic goals and objectives, defined in the 2013–2018 State Tobacco Control Strategy. Sakartvelo successfully applies international measures, especially as it relates to the articles and recommendations provided in the WHO Framework Convention on Tobacco Control.

The so-called “New Generation Law” for tobacco control was passed in 2017, and anti-smoking policies have been in place since 1 May 2018, when all tobacco advertising and trade promotion measures were banned and special rules for the sale of tobacco products were established. On 1 September of the same year, drive tobacco was banned and the new packaging and design rules for tobacco products were introduced, including the use of large-format medical warnings about the harm of tobacco to health and the use of the relevant pictograms on tobacco packaging.

In 2017, the amendments to the laws on tobacco control, advertising, broadcasting, lotteries, profit-making and gambling were adopted. The amendments to the Code of Administrative Offenses and the Tax Code entered into force in 2018. Also, in 2018 the following ordinances were adopted:

1. On 15 January 2018 – Government Resolution No. N14 “On the rules regulating the maximum norms of active substances (nicotine, tar, carbon gas) in cigarettes

with filters and without filters, measuring and regulating the amount of the active substances and providing medical warnings at the points of cigarette sales, on the boxes / blocks and packages”.

2. On 1 May 2018 – Order of Sakartvelo Minister of Labour, Health and Social Affairs No. N01–20/N “On the approval of the forms of information reporting documents about the standard-based measurement of the amount of active substances (nicotine, tar, carbon gas) in cigarettes with filters and without filters, submitted in a mandatory manner by a manufacturer and/or importer of tobacco products”.
3. On 1 May 2018 – Order of Sakartvelo Minister of Labour, Health and Social Affairs No. N01-19N “On the approval of broadcasting and the use of radio icons to indicate the harm of smoking in the cases of the use of tobacco products, tobacco accessories and/or tobacco while demonstrating a video or other creative product”. In addition, based on Article 5.3 of the WHO Framework Convention on Tobacco Control, a draft resolution of the Government of Sakartvelo “On the protection of tobacco control state policy in public institutions and the approval of state relations with stakeholders of the tobacco industry” was prepared.

Developments in the implementation of the major articles of the WHO Framework Convention on Tobacco Control in Sakartvelo:

1. Article 8 of the WHO Framework Convention on Tobacco Control – Protection against exposure to tobacco smoke – implementation:
  - Laws prohibiting the use of tobacco in public/workplaces;
  - About 96 percent of the laws will be implemented, but their full implementation requires strengthening and promoting the civil society activism and obedience to the tobacco control laws.
2. Article 9 of the WHO Framework Convention on Tobacco Control – Regulation of the constituents of tobacco products – implementation:
  - Regulation of the permitted norms of nicotine, tar and carbon gas in tobacco products;
  - On 15 January 2018, Government resolution No. N14, which established the maximum permitted norms of the constituents of tobacco products and introduced the requirement to provide information about the constituents of the tobacco products; however, full implementation of the resolution requires systemic strengthening of activation mechanisms and inter-institutional cooperation.
3. Article 11 of the WHO Framework Convention on Tobacco Control – Packaging and labelling of tobacco products – implementation:
  - Medical warnings on tobacco products;
  - Sakartvelo Tobacco Control Law and Resolution No. N14 of 15 January 2018 indicate which percentage of the surface area of a packaging (a package/block/box) of tobacco products must be occupied by medical (basic and additional) information (icons). Medical information must take up at least 30 percent of the surface area of inhalable tobacco and at least 65 percent of the surface area of all other types of tobacco product packaging. Information

rotation is allowed. Provision of false, misleading or incorrect information about the composition of tobacco products, harmful effects, etc. is also prohibited. Based on the National Tobacco Control Act, a standardized tobacco products packaging is mandatory from January 2021.

4. Tobacco advertisement prohibiting environment. On 30 May 2017, the Parliament of Sakartvelo adopted a package of legislative amendments. It establishes the legal basis of the new generation of tobacco control, which fully reflects compliance with the obligations under the Association Agreement between Sakartvelo and the EU and the WHO Framework Convention on Tobacco Control. It should be noted that the new laws prohibit any advertising, sales promotion and sponsorship of tobacco products, tobacco accessories and smoking equipment. The aforementioned amendments to the Sakartvelo's legal framework *inter alia* include tobacco control; they are related to the regulation of advertising, broadcasting, lotteries, gambling and profit-making games, administrative violations and the relevant amendments to the Tax Code. Tobacco Control ordinances, including the Order of Sakartvelo Minister of Labour, Health and Social Affairs No. N01-19N of 1 May 2018, stipulate that if television, radio and other mass media broadcast material, the content of which includes tobacco products or their use, then the mass media shall provide a pre-broadcast warning/notification and post-broadcast warning/notification about the harm caused by tobacco.
5. Tobacco product sale and its regulation – newly emerging products. The laws adopted on 30 May 2017 brought the legal framework regulating the sale of tobacco products in Sakartvelo closer to the EU and international standards. The EU Directive No. 2014/40/ determined the following changes in the Sakartvelo's legal framework:
  - the control of toxic substances in tobacco products was introduced;
  - the obligation to provide information about the constituents of tobacco products was introduced;
  - the so-called “plain packaging” standard was adopted;
  - tobacco advertising, sales promotion and sponsorship were prohibited;
  - storing tobacco products in visible places at points of sale was prohibited;
  - the surface area occupied by medical warnings (icons) about the harm caused by tobacco products (both basic and additional information) on tobacco product packages was increased to at least 65 percent of a package (block / box);
  - regulation of electronic cigarettes and smokeless tobacco was introduced;
  - retail sale of tobacco products by using mechanical and electronic devices, the Internet and mail was prohibited
  - the quantity of 20 cigarettes in one packet is allowed; the sale of unrolled cigarettes is prohibited.
6. Sakartvelo has been using a tobacco product labelling and identification system which meets the requirements of the EU directive No. 2014/40/. However, there are also problematic areas that have not yet been covered by the country's legal framework. These are:



- combined medical warnings about the harm of tobacco, placement of information in small print pages, elimination of other technical differences;
- strengthening the composition and safety control of electronic cigarettes and other devices;
- control of additives in tobacco products;
- prohibition of the use of flavour enhancers;
- prohibition of chewing tobacco;
- unification of some differences in terminology not to weaken the content of the adopted legal norms.

Sakartvelo's legal framework is supported by at least 85 percent of the population, and the law abidance rate amounts to 98 percent. In accordance with Article 8 of the WHO Framework Convention on Tobacco Control, which directly enshrines protection measures against passive smoking, Sakartvelo has been striving to implement the strategic goals and objectives defined in the Tobacco Control Strategy and the Action Plan. In 2013, the National Centre for Disease Control and Public Health was established. The purpose of the Centre is to strengthen tobacco control measures in close cooperation with non-governmental organizations, the health care sector and international organizations, especially the World Health Organization, and to carry out public health programs.

Despite the positive results achieved in the area under consideration, Sakartvelo still needs to ensure the continuity of tobacco control, as well as monitoring and improving the existing legal framework.

Tobacco control is a significant aspect of Sakartvelo's EU integration process. In accordance with the Association Agreement between the EU and Sakartvelo, concluded in 2014, one of Sakartvelo's obligations is effective application of the international agreements recognized by the EU member states in the area of health care. This is especially true of international health care standards and the provisions of the WHO Framework Convention on Tobacco Control.

According to Article 71 (e) of the Association Agreement, the parties shall cooperate in combating and preventing illegal trade in goods, including tobacco products, across national borders.

According to Article 283 of the Association Agreement, the parties shall take countermeasures against smuggling of excise goods by expanding cooperation and gradually harmonizing excise tax rates for tobacco products, taking into account the situation in regions and the provisions of the WHO Framework Convention on Tobacco Control. The countries shall seek to strengthen regional cooperation.

The process of smuggling of tobacco products is also subject to customs regulations issued by the Customs Department with the Revenue Service under the Sakartvelo Ministry of Finance. In accordance with Part 14 of Article 289 of the Customs Anti-Smuggling Act, if a case of smuggling is detected, the offender is punished with a monetary fine as a sanction.

## Conclusions

Smuggling refers to illegal transportation of certain items or things across national borders by evading customs control when the items or things are transported to illegally satisfy the demand for prohibited or highly taxed goods or services. The major macro-economic determinants of smuggling are regional and international economic integration, globalization, international trade barriers and their reduction, and inflation; the major tax determinants are taxes applied to goods and the general tax burden; the major legal determinants are strength (weakness) of the legal framework and border control (in)efficiency; the major institutional determinants are corruption and the quality of public institutions; the major social determinants are income inequality and poor protection of individual rights; the major market determinants are consumer demand and product retail prices.

Tobacco control is a significant aspect of Sakartvelo's EU integration process. In accordance with the Association Agreement between the EU and Sakartvelo, concluded in 2014, one of Sakartvelo's obligations is effective application of the international agreements recognized by the EU member states in the area of health care. Sakartvelo's legal framework is supported by at least 85 percent of the population, and the law abidance rate amounts to 98 percent. In accordance with Article 8 of the WHO Framework Convention on Tobacco Control, which directly enshrines protection measures against passive smoking, Sakartvelo has been striving to implement the strategic goals and objectives defined in the Tobacco Control Strategy and the Action Plan.

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