

Lithuanian Free
Market Institute

**Population
attitude
survey
towards
smuggling
and
consumption
of illegal
goods
2013**



Introduction

Be the spread of the shadow economy phenomena large or small, participation of people is a part of it. Therefore, attitudes of the public at large towards the activities of smuggling and the use of illegal goods influence the spread of these goods and ability of governmental institutions to combat shadow economy. Attitudes of the population also influence the impact of changes to regulatory and taxation environment on both legal and illegal markets.

Precisely for these reasons, Lithuanian Free Market Institute (LFMI) is conducting a survey of population attitudes towards smuggling and consumption of illegal goods since 2004. For the second year this survey has been conducted in Lithuania, Latvia and Estonia.

The newest, representative opinion poll research in the three Baltic States by the order of LFMI, in January 2013 was conducted by “Spinter research”, which questioned 3033 permanent residents of Lithuania, Latvia and Estonia: 1004 in Lithuania, 1026 in Latvia and 1003 in Estonia. Age of the participants ranges from 18 up to 75 years old.

Chief researcher – LFMI senior expert Vytautas Zukauskas.

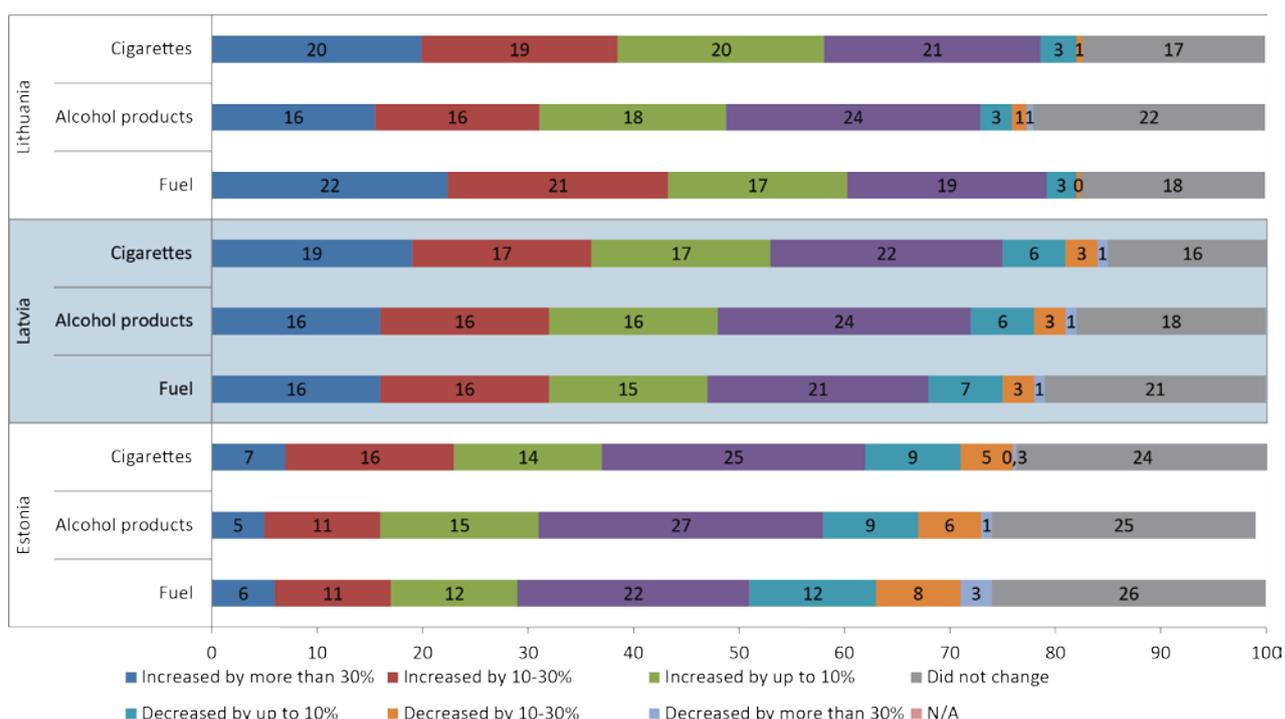
Further in the study, data from current and previous researches will be analyzed.

Research data and analysis

1. The largest increase in the use of illegal goods – in Lithuania

The highest number of people who think that the scale of illegal goods used in 2012 has been increasing were in Lithuania, followed by Latvia and Estonia.

In your opinion, has the consumption of these illegal goods in Lithuania / Latvia / Estonia been increasing, decreasing or has not changed during the last three years?



59% of Lithuanians think that the consumption of cigarettes in 2012 has increased (20% of them thought, that it increased by more than 30%). Similar numbers were in Latvia – 53%, in Estonia it only reached 37%.

60% of Lithuanians think that the consumption of illegal fuels in 2012 increased. In Latvia 47% of people claims the same, while in Estonia only 29% of people do so.

According to 50% Lithuanian respondents the use of illegal alcohol and its products has increased during 2012. In Latvia 48% of people are support the same statement, whereas only 31% of Estonians think this way.

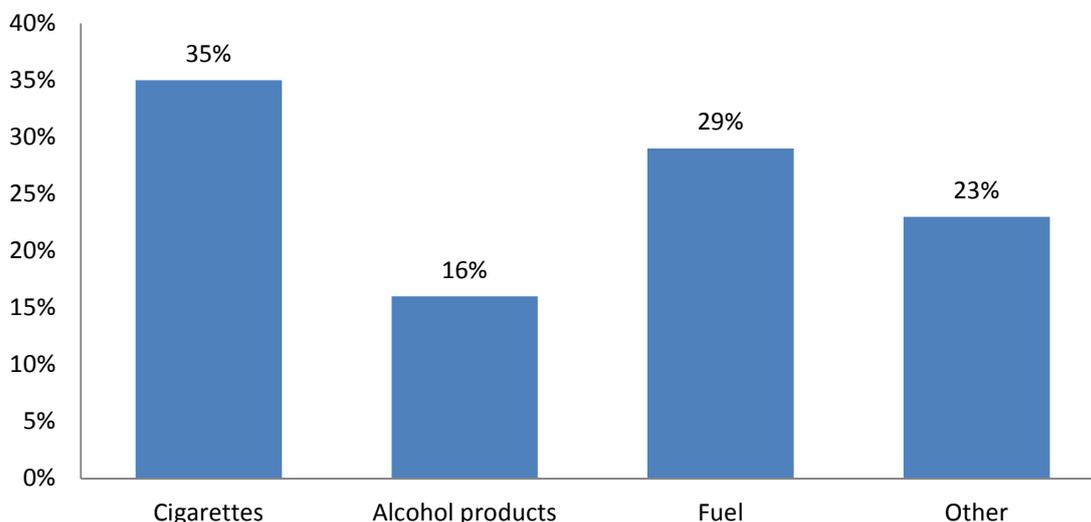
In all of the counties and across all excise goods categories, there were more people who claimed that in 2012 the use of these goods has been increasing, than those who said that it has been decreasing. This data suggests, based on the views of the participants, that smuggled and illegal goods are widely spread in Lithuania and other Baltic states.

2. One out of three Lithuanians buys smuggled cigarettes and fuel

Lithuanians were given an additional question in order to find out the use of smuggled and illegal goods. They were asked if they or their family members in 2012 have purchased any contraband or unofficially made and sold goods or services (given they knew that these goods are illegal or seller is not accounting the income or it was not a legal business). This question seeks to directly evaluate the spread of illegal goods.

When analyzing this question, we have to keep in mind, that people who were asked this question, did not always answer honestly, i.e. some of them just did not admit publically the consumption of illegal goods. Therefore, the positive answers of this question have to be viewed as a “floor”, i.e. at least these respondents had actually bought illegal goods and services, even though the share can be even higher. More importantly, this question represents a fact if the person in 2012 had purchased any illegal goods or services, not the opinion of a person on smuggling.

Did you or your family members acquire any smuggled or illegally made and sold goods or services in 2012?



In 2012 the largest part of the population of Lithuania has purchased illegal cigarettes. 35% of respondents said so. Fuel took the second place; 29% of people acquired these goods. In the third place is category “other” with 23%, which includes various goods (i.e. household goods, wood, cars, and clothes) and services (i.e. construction work, beauty services, medical and esthetics, catering services, nursing, and other).

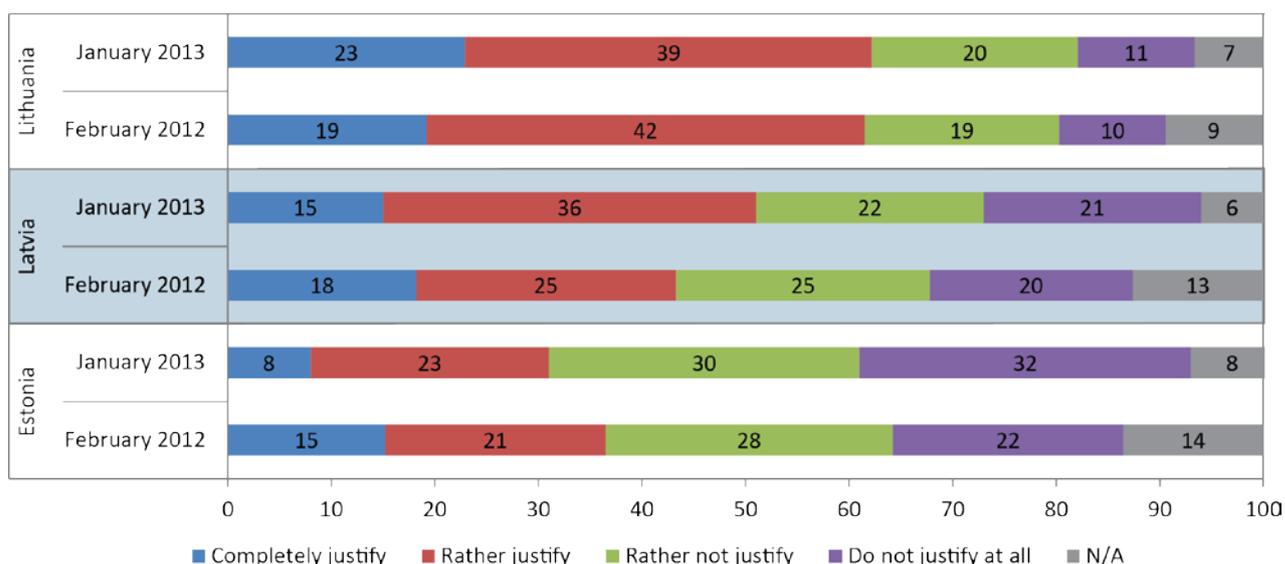
Mentioned excise goods are the most spread illegal goods, because a large part of the price of these goods constitute high taxes (cigarettes around 80%, strong alcohol around 60% and fuel around 50%), when sold legally; due to the high price these goods end up in illegal market. By and large, illegal goods turnover is a consequence of avoiding taxes.

3. Lithuanians and Latvians justify smuggling and consumption of illegal goods more than Estonians

In Lithuania and Latvia the larger part of population justifies smuggling and illegal consumption of cigarettes, alcohol products and fuel. 62% of Lithuanians in January 2013 justified the use of smuggled and illegal goods, in contrast to the 31% who did not justify. In Latvia it was 51% who justified and 43% who did not.

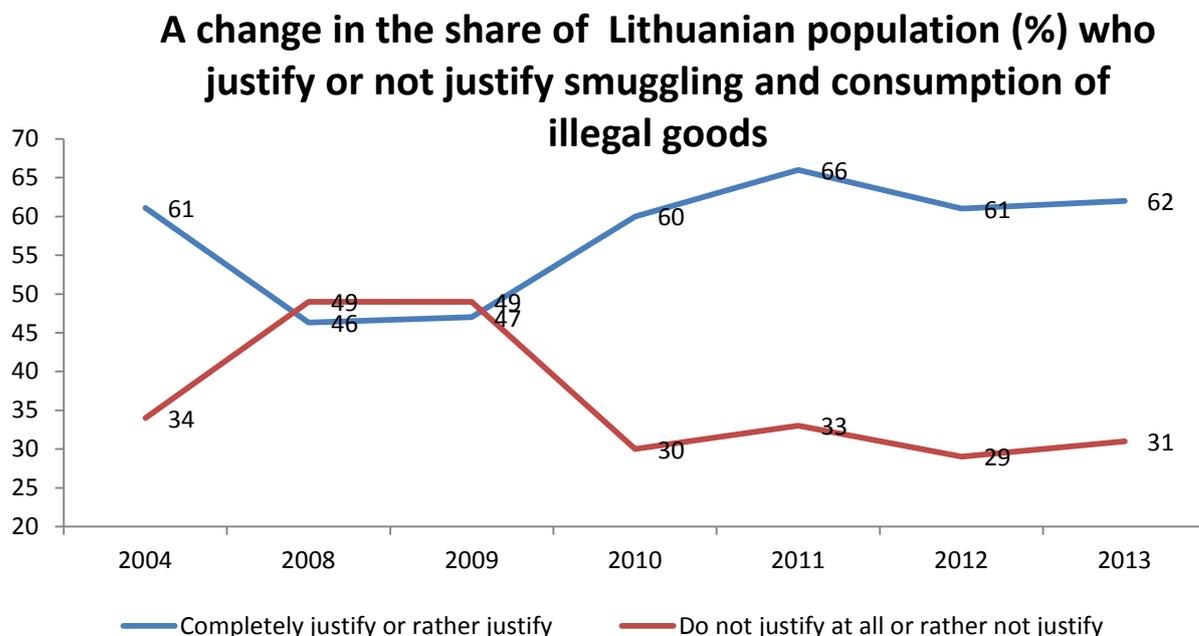
Estonia is the only country out of the three being researched, in which usage of smuggling and illegal goods was justified or completely justified only by 31% and was much smaller than the share of people who do not justify or completely do not justify these actions (62%). In addition, if compared to 2012, in Estonia the share of people who justify the use of smuggled and illegal goods has been decreasing.

How do you personally evaluate smuggling (contraband) and illegal consumption of cigarettes, alcohol products and fuel?



4. Lithuanians justify smuggling more, when economy grows worse

In the period 2004-2008 the share of those who justified smuggling and consumption of illegal goods was decreasing and the share of those who do not justify was increasing, shows the dynamics of shares. In 2008 and 2009 the share was similar between who justified and did not. From 2010 a large increase can be seen towards justification and a large decrease for those who did not.

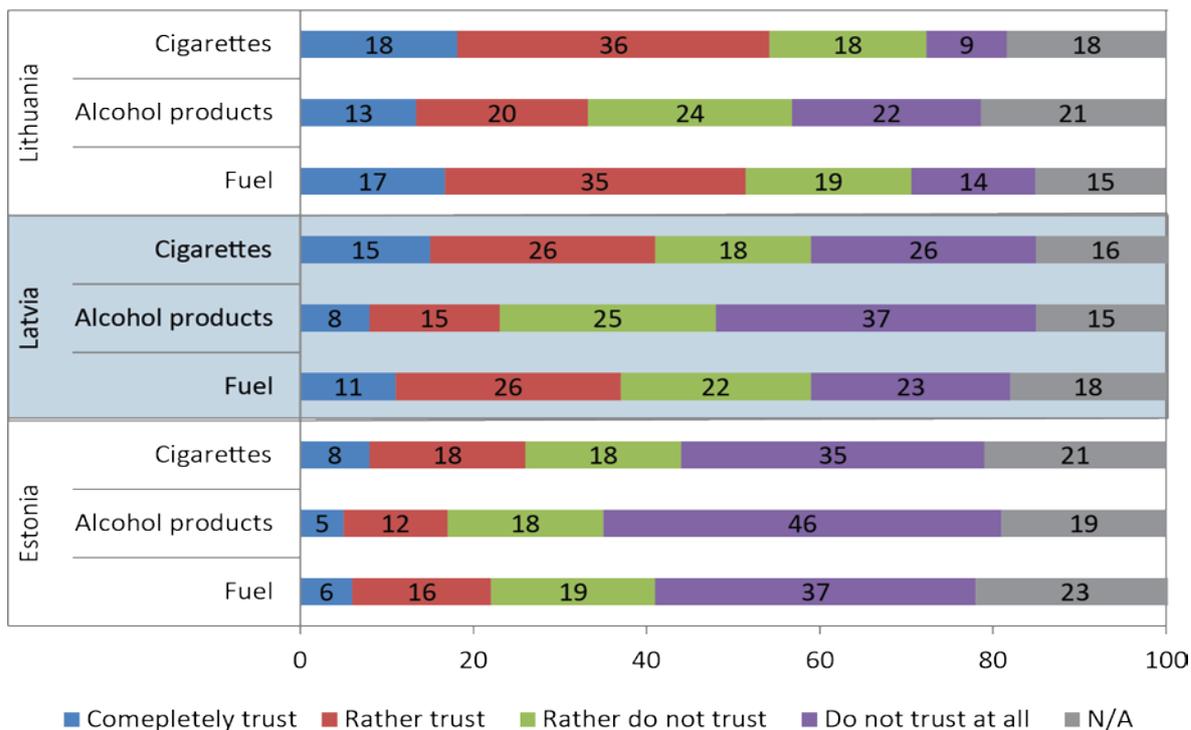


The spread of smuggled and illegal goods is related to attitudes of people towards these goods. The more people are willing to justify these goods, the greater the consumed amounts become and the more difficult is for law enforcement institutions to deal with the phenomena. Moreover, attitudes of populations towards the illegal goods change depending on the economic and social conditions of the particular country. When the economic situation of citizens worsens, they are more willing to justify phenomena of the shadow economy.

5. Quality of illegal goods: Lithuanians trust, Estonians doubt

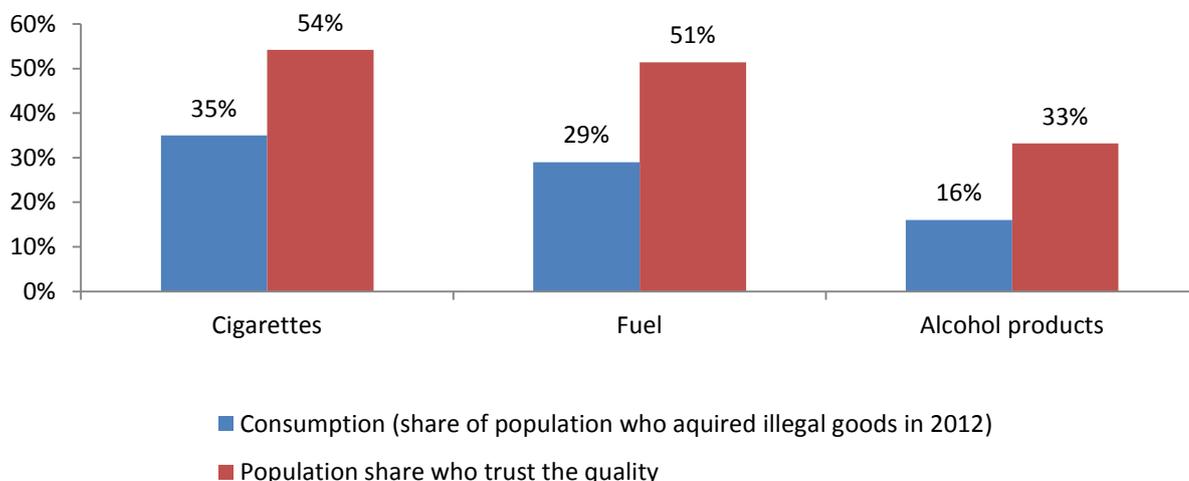
Out of the three Baltic States, the most the quality of illegal goods is trusted by Lithuanians, followed by Latvians. Estonians trust the least. In all three countries people trust in alcohol product quality the least, while in cigarettes the most.

Do you trust the quality of illegal goods?



54% of Lithuanians are satisfied with the quality of cigarettes, 52% trust in the quality of fuel, while only 33% trust in the quality of alcohol. 41% of Latvian population trusts the quality of cigarettes, 37% trust in fuel quality and only 23% trust the quality of alcohol. Estonians are the most skeptical among the Baltic States regarding the quality of illegal goods – 26% trust in cigarette quality, 22% trust in fuel quality and only 17% trust in alcohol quality. Interestingly, only in Lithuania in 2013 there were more people who trusted in the quality of illegal goods, than those who did not (only cigarettes and fuel).

Consumption and quality of illegal goods



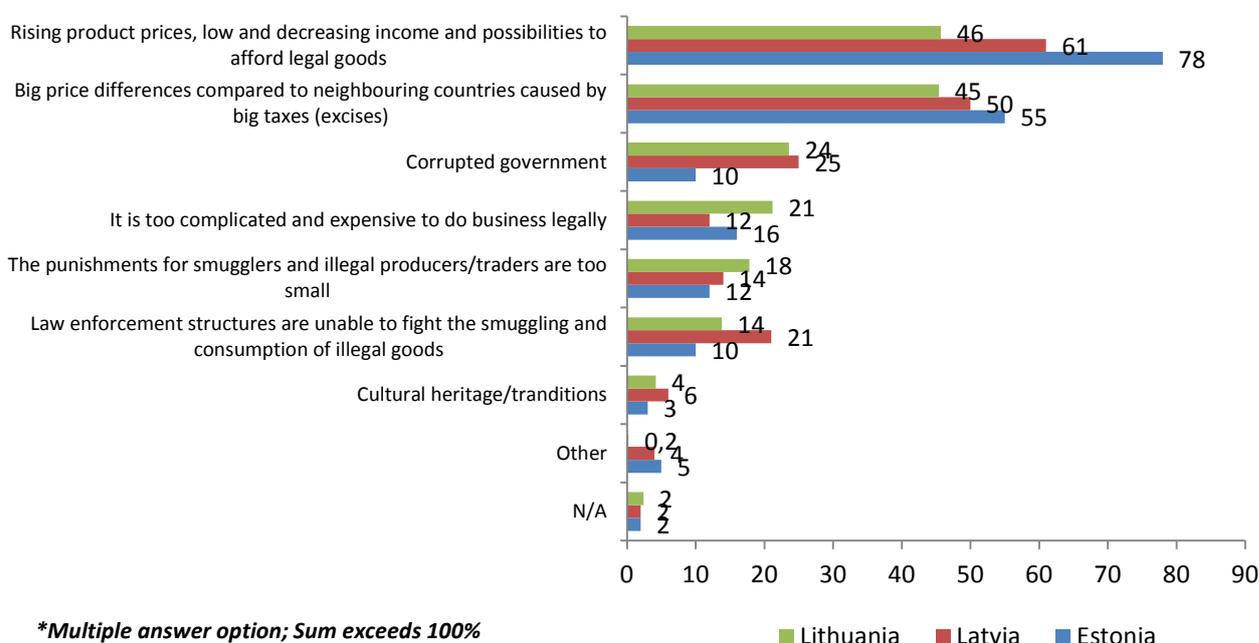
The more people trust in the quality of illegal goods, the more they are willing to consume these goods, as the data of the research shows. People trust the most in the quality of cigarettes, followed by fuel and finally by alcohol products. The same trend emerges, when people are asked to tell what illegal goods they have acquired in 2012. Results show, that people did acquire goods, in which quality they trust the most.

6. Reasons for consuming smuggled and illegal goods – excise taxation and decreasing possibilities to afford legal goods

According to citizens of all three Baltic States the main reasons for the spread of smuggled and illegal goods and service are: firstly, increasing prices of commodities, decreasing earnings and decreasing ability to buy goods legally, and secondly large difference in prices of the excise goods if compared with neighboring countries, which are determined by large excise taxation.

78% of Estonians think that the first reason is one of the most important, 61% of Latvians and 46% of Lithuanians think the same. Price differences as a one of the major reasons was mentioned by 55% of Estonians, 50% of Latvians and 45% of Lithuanians. The third reason in importance in Latvia and Lithuania is corruption in the government, while Estonians say it is too costly and too difficult to do business legally. A significant difference between the Baltic States can be observed with regard to the corruption in the government, because twice as more Lithuanians and Latvians than Estonians emphasize this problem.

How do you think, what are the reasons for prevalence of smuggling (contraband) and illegal production and trade of goods?



Data that has been collected indicate that in all three Baltic States people provide similar reasons for the spread of illegal goods. The two main reasons are interrelated. On the one hand, the spread of illegal goods is a result of large prices for the similar or same legal products, which are determined by extensive taxation of these products. On the other hand, people feel the effect of extensive taxation, when the income is low; to buy these products legally a relatively large part of income has to be put forward.

The price differences of goods that are taxed by excise duty in Lithuania and neighboring non EU countries are substantial. The table below shows that prices of some goods are up to 7 times higher in Lithuania than in Belarus – main source of smuggled cigarettes in Lithuania. That effectively means huge economic incentive for smuggling. Prices differences are even bigger when calculated in western countries of EU, where excise taxes are even higher than in Baltic countries.

	PRICE IN LITHUANIA	IN RUSSIA (KALININGRAD DISTRICT)	IN BELARUS
0.5 litre of vodka	18 Lt*	11,9 Lt*	11,97 Lt*
1 litre of diesel fuel	4,71Lt**	2,54 Lt**	2,56 Lt**
1 pack of cigarettes	7,77 Lt***	2,07 Lt****	1 Lt****

* Source: AGPIA

** Sources: degalukainos.lt, www.ariscard.com (30.8.2012)

*** Weighted average price of cigarettes in 2012

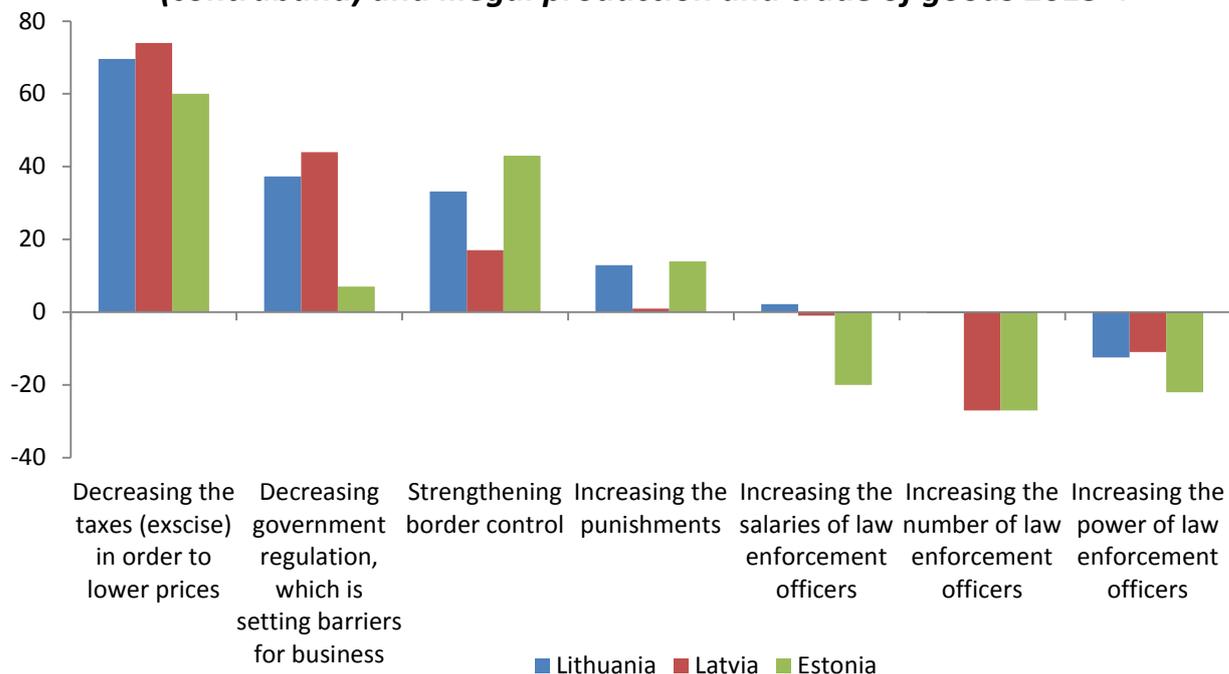
**** Price of cigarettes which represent the highest percentage of illegal market in Lithuania (based on the Russian and Belarusian rouble exchange rate on 30 August 2012)

7. Ways of combating smuggling and consumption of illegal goods: tax reduction is the most important

The most effective measure, according to the population of Lithuania, Latvia and Estonia, to combat smuggling and illegal goods and services production is to lower taxes, in order to decrease prices. 60% more people thought of it as more effective than ineffective measure in all of the Baltic States.

Lithuanians and Latvians name reducing government regulation, which interferes with starting and doing business, as the second effective measure when combating the spread of illegal goods. Meanwhile, Estonians think that the second important measure is to strengthen border control. In all countries the share of people, who positively evaluate a measure such as increasing the number and wages of law enforcement officers, was similar or smaller than the share of people who see it in negative light.

Effectiveness of the following ways to fight smuggling (contraband) and illegal production and trade of goods 2013*.



* Difference between the share of people who believe the measure to be effective if compared with who believe to be it ineffective.

People across the Baltics States think that the most effective ways to combat the spread of illegal goods are ones which are directed towards reducing incentive to operate in the shadow economy, i.e. to lower price of excise goods, so that the trade of these goods would be less profitable. Administrative or increased punishment measures are seen as less effective.

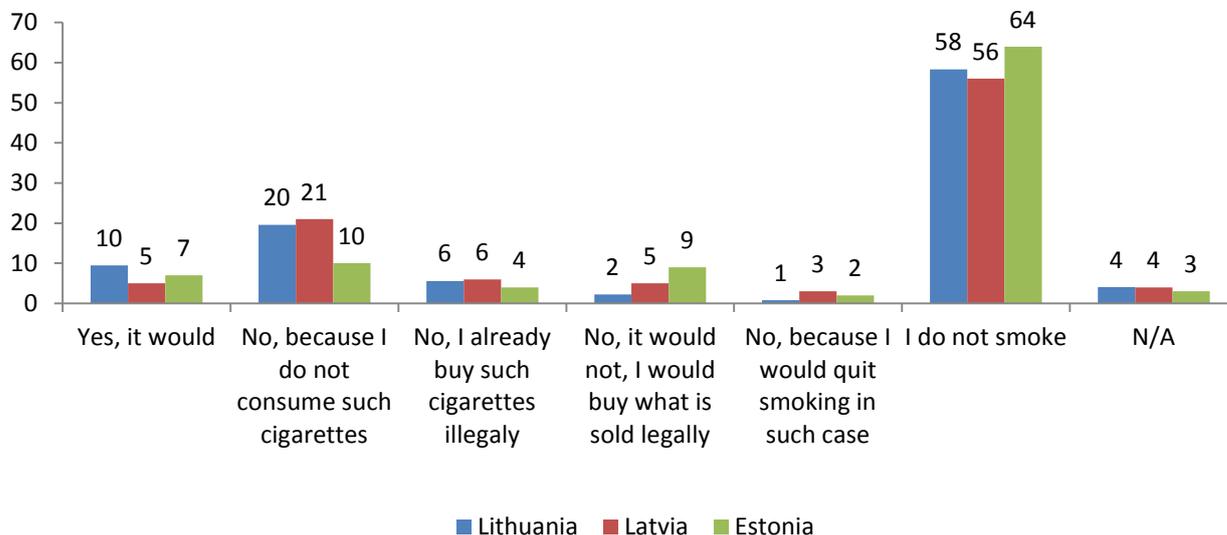
8. Prohibition increases incentive to search for goods in illegal market

The second most important reason for the spread of smuggling and consumption of illegal goods according to people is the fact that large price differences are evident between neighboring countries, which are determined by large excise taxes. Incentives to look for goods in illegal market and participate in the shadow economy can be affected not only by taxes, but as well by additional regulations, i.e. ban on certain products.

One example of such regulation is European Commission Tabaco Directive proposal in 2012 to ban the sale of different flavor cigarettes and to control the size and shape of the cigarettes. Given that the European Parliament approves the proposal by the European Commission, mint and other flavor (non-Tabaco) cigarettes would become illegal. Constraints of the size and shape of cigarettes would be applied.

This new regulation can have an effect not only on the habits of the smokers, but to the illegal cigarette market as well. In the survey respondents were asked, weather a ban to sell different flavor and shape cigarettes (i.e. mint and slim) would encourage people to look for such products in the illegal market. This question helps to evaluate the effect of new regulation on the illegal Tabaco market.

Would prohibition to sell cigarettes of various tastes and thickness (mint or slim) legally stimulate you to look for such goods in illegal market?



10% Lithuanians, 5% Latvians and 7% Estonians would purchase different flavor and shape cigarettes in the illegal market if such regulation would take effect and there would be none of them in the legal market (if counting only the smokers the number increases to 23%, 11% and 20%). The share of the people, who would be encouraged to look for such cigarettes in the illegal market, is greater than the share of those who would quit smoking (1%, 3% and 2%). Some respondents are already purchasing illegally such cigarettes, which can be banned by new regulatory proposals.

When new regulations are introduced or taxes are increased, a part of population become participants of illegal market, in order to satisfy their needs, because goods in this market are cheaper or certain goods can only be found in the illegal market. These results fully illustrate the consequences of taxation and regulation to the illegal market – increasing regulation or constraints and increasing taxes in the legal market encourage more people to look for goods illegally.

Conclusions

- According to citizens of Lithuania, Latvia and Estonia the spread of smuggled and illegal goods is wide. The survey provided evidence, that one out of there Lithuanians has purchased cigarettes or fuel illegally in 2012.
- Lithuanians justified the use of smuggled and illegal goods the most in comparison to Latvians and Estonians. When economic situation becomes worse, people more often justify phenomena in the shadow economy. Justification creates favorable conditions for the use of these goods; it also makes it harder for the law enforcement to combat shadow economy.
- People trust the quality of the cigarettes the most, followed by fuel. The quality of alcohol products is trusted the least. Survey data show that the more people trust in the quality of the illegal goods, the more they are willing to buy these goods.

- Increasing goods prices, decreasing people's income and large price differences with neighboring countries are being indicated as the most important reasons for the increased spread of smuggling and illegal goods in all three Baltic States.
- According to people, the most effective ways to combat shadow economy are to lower taxes (excise), in order to reduce the price of these goods, because it would reduce incentive to participate in the shadow economy. The second measure according to Lithuanians and Latvians is to reduce government regulations, which interfere with business activities.
- When new regulations and prohibitions are introduced, a part of population becomes participants in the illegal market to satisfy their needs. For example, a ban on different flavor and shape cigarettes in the Baltic States would encourage 11% of Estonians and 23% of Lithuanians who smoke this kind of cigarettes to look for them in the illegal market.