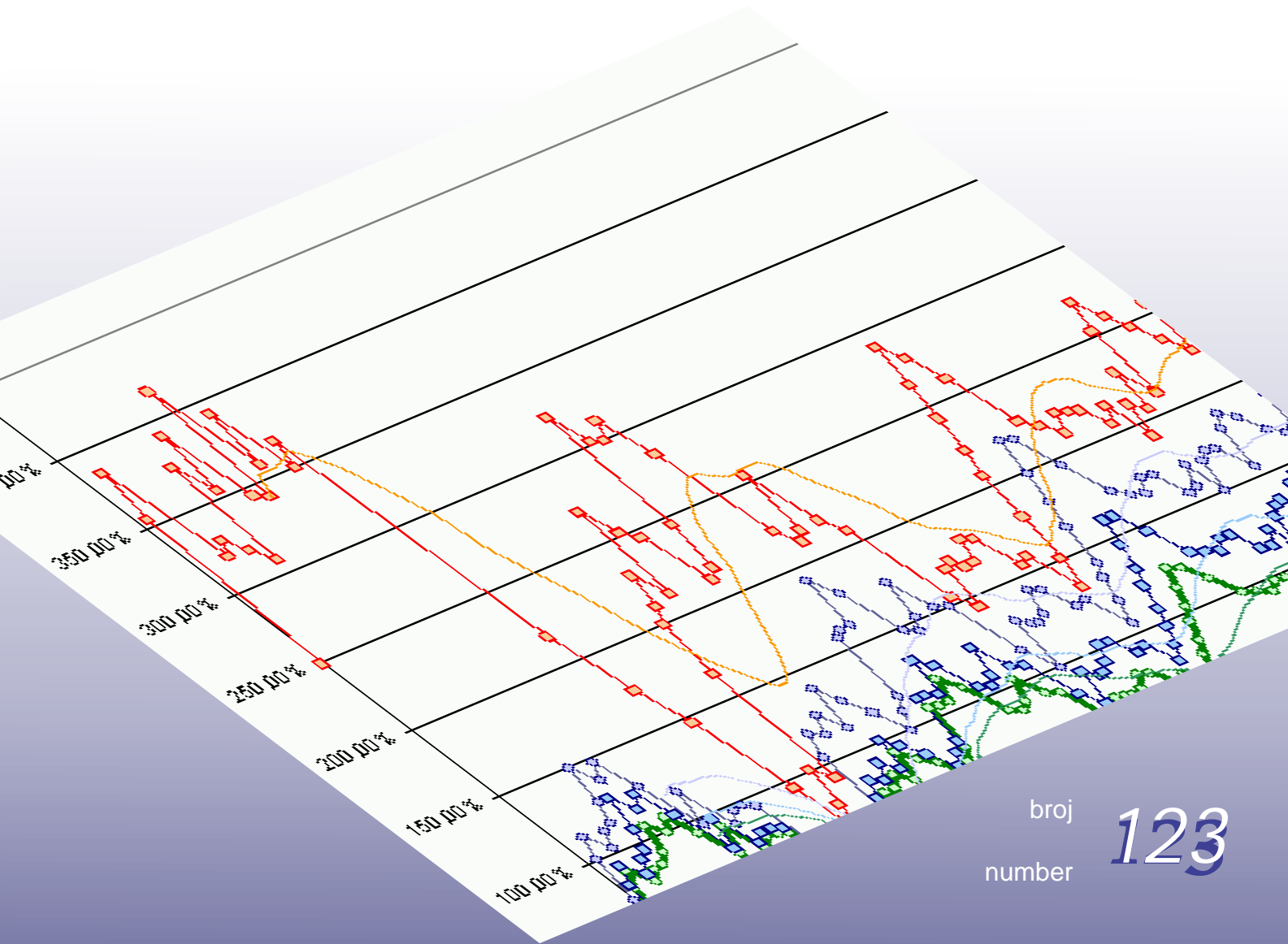


Bosna i Hercegovina  
Odjeljenje za makroekonomsku analizu  
Upravnog odbora Uprave za indirektno-  
neizravno oporezivanje



Macroeconomic Unit of the Governing Board of the Indirect Tax Authority

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## With this issue

According to the preliminary cash flow report on the ITA SA, it was collected in September 574,4 million KM of gross revenues from indirect taxes or 8 million KM more than in the same month of 2014. Since the refunds were reduced by as much as 30 million KM, the net revenue growth amounted to 38 mil (Chart 1) or 8,5% more than in September 2014. The positive trends in September led to an increase in the cumulative surplus at the period January - September. Total gross collection amounted to 4,717 billion KM, representing an increase of 142,68 million or 3,1%. Reduction of refunds contributed to the growth of cumulative net surplus to 181,8 million KM (Chart 1), representing an increase of 4,9% in comparison with nine months 2014.

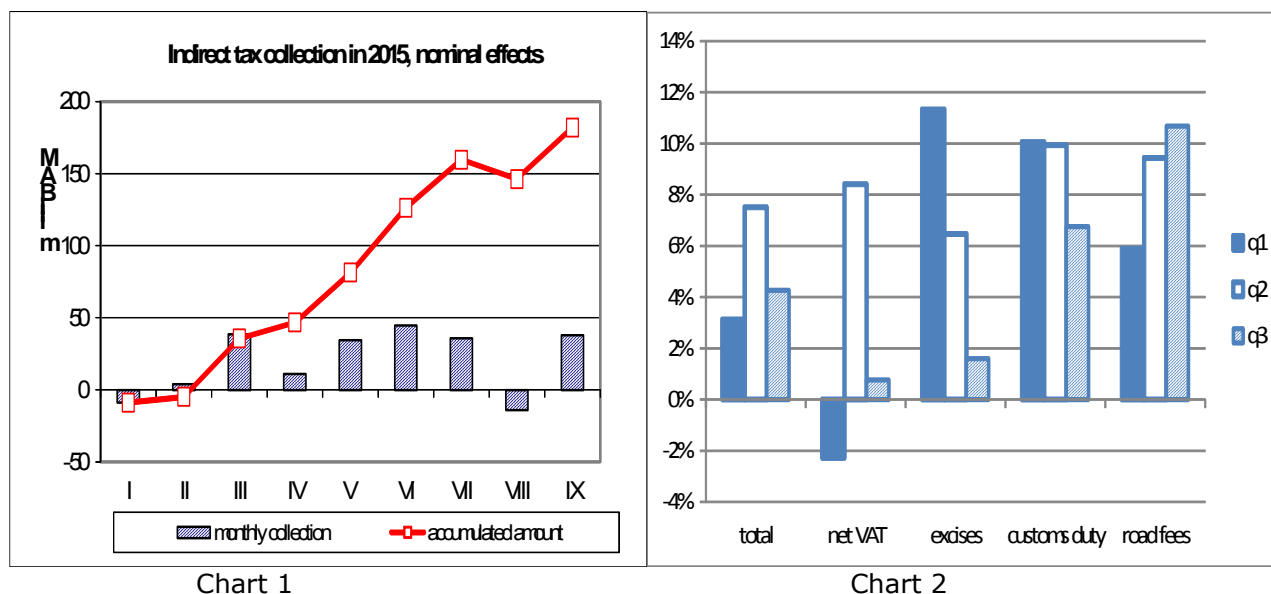


Chart 1

Chart 2

Observation by types of revenues for the nine months of 2015 shows the highest growth in revenues from excises and road taxes, a total of 104,6 million KM, from VAT of 51,7 million KM, and from customs revenues of 10,4 million KM. It should be noted that, according to the preliminary report, it was recorded an additional 25,5 million KM of unadjusted revenues, which have not yet been allocated by type. Quarterly comparisons show divergent trends in revenue collection during the year (Chart 2). The growth in the first quarter was generated by revenues from excises and road taxes, while the growth in the second quarter resulted from the strong increase of VAT. The third quarter of 2015 brought the expected slowdown in excise revenue due to the depletion effects of changes to the Law on Excise Duties in the area of tobacco taxation, and the modest growth of VAT. Continued growth in revenues from road taxes indicates that in the structure of the excise growth in the third quarter prevailed the growth of excises on oil derivatives.

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Head of Unit

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## The effects of amendments to the Law on Excise Duties on taxation of tobacco products

(Author: Dinka Antić, PhD)

*Amendments to the Law on Excise Duties in the area of tobacco apply from 1<sup>st</sup> of August 2014. Main changes relate to the introduction of the specific excise duty on fine-cut tobacco and its annual adjustment with the increase in minimum excise duty on cigarettes. Specific excise duty on fine-cut tobacco is increased to 80 KM/kg and specific excise duty on cigarettes to 1,05 KM/pack by the Decision of the Indirect Taxation Authority Governing Board for 2015.*

### Trends in 2014<sup>1</sup>

The market of tobacco products in B&H before the adoption of amendments to the Law on Excise Duties was characterized by the following situation:

- The widening gap in the tax burden on cigarettes and fine-cut tobacco has led to an escalation of substitution of cigarette consumption with the consumption of, mainly untaxed, cut tobacco and cigarettes manufactured in a 'home craft business' or illegal plants, resulting in a decline in cigarette consumption of 21% in the first half of the year<sup>2</sup>;
- As an indicator of flourishing the black market of tobacco and illegal production of cigarettes stands a fact that for seven months the import of cigarette rolling machine papers increased by 18% in a situation where a strong decline in domestic production of cigarettes is recorded;
- Decline in cigarette consumption and migration of consumers from the legal to illegal tobacco market led to tax evasion, so that a decline in revenue from excise duties on cigarettes of 11,2% was recorded in the first half of the year.

The adoption of amendments to the Law on Excise Duties has already constituted a trigger for changing the business strategy of the tobacco industry. Drastic increase in the excise burden of fine-cut tobacco urged the accumulation of fine-cut tobacco, especially by the domestic tobacco industry, which is difficult to explain, given the fact that the production of cigarettes delivers a higher added value and thus higher profits in relation to the production of cut tobacco for smoking.

After the entry into force of amendments to the Law, there was a big change. It is shown by following indicators:

- The cumulative consumption of domestic taxable fine-cut tobacco is reduced to the level from the year of 2013 and volumes of imported cut tobacco have been reduced by 32%. There was also a decline in the market value of fine-cut tobacco by 6,8%, with the value of domestic tobacco market still increased by 6,9%;
- Import of papers for machine production has stabilized at the level of imports from 2013 for these months;
- There has been a continuous increase in the amount of cigarettes, which largely mitigated negative trends from the first half of the year and finally, stabilized a drop in the consumption at 8,4% at the level of the year, which can be considered as acceptable, given the fact that as of 1<sup>st</sup> of January 2014 the excise duty on cigarette has been increased;

<sup>1</sup> Analysis relating to the effects of the application of amendments to the Law on Excise Duties in 2014 was published in the Bulletin no. 114, January 2015, [www.oma.uino.gov.ba](http://www.oma.uino.gov.ba).

<sup>2</sup> The consumption of cigarettes for the purpose of this analysis implies the amount of issued excise stamps, while the consumption of fine-cut tobacco is measured in kilograms per packages for which excise stamps have been issued.

- New trends in the tobacco market in B&H have brought an increase in revenue from excise duties, which, at the level of the year, brought a surplus of 30,8 million KM of excises compared to 2013, or 8,3 million KM more excises than the projected collection.

It can be concluded that in a very short time the tobacco market stabilized due to amendments to the Law on Excise Duties. One of the objectives of amendments to the Law has been achieved and that is, in the first step, to reach the revenue collection from 2012 which has so far represented a historical maximum.

### *Trends in 2015*

Positive trends in the market of tobacco products continued during the eight months of 2015. Compared to the same period in 2013 the consumption of taxed (branded) fine-cut tobacco amounted to only 6-8%, with a greater decline over time recorded in imported tobacco (Chart 1). Still, in the first quarter a drop in consumption was milder and then it has stabilized.

Chart 1

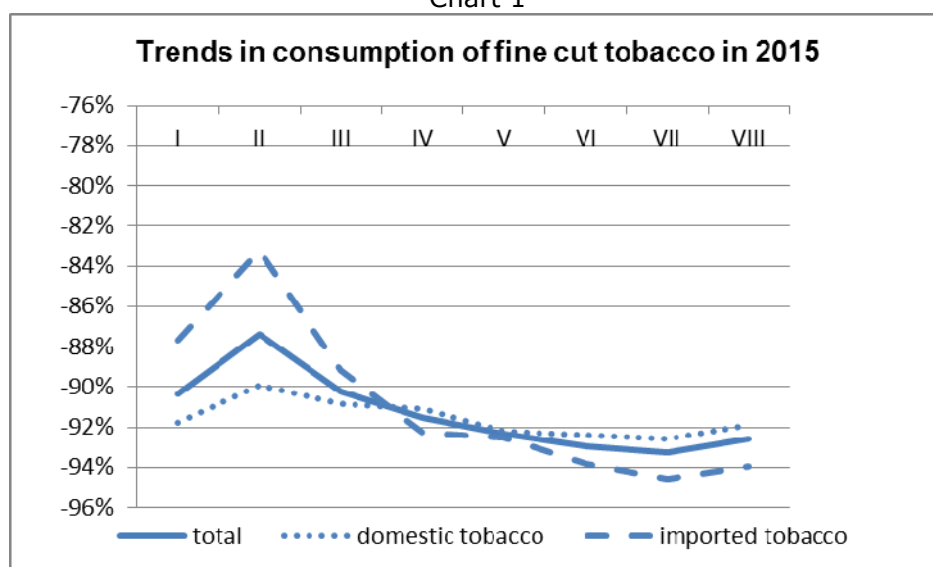
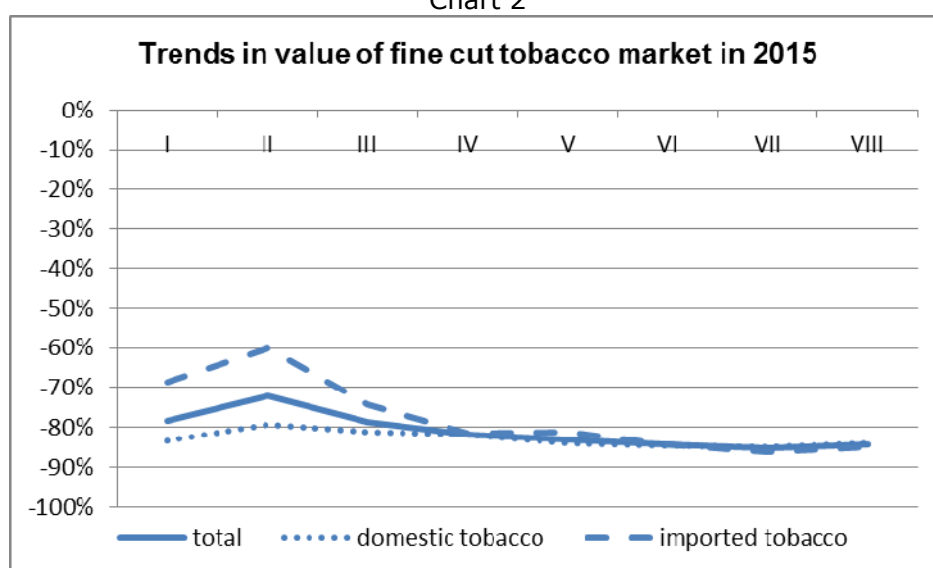


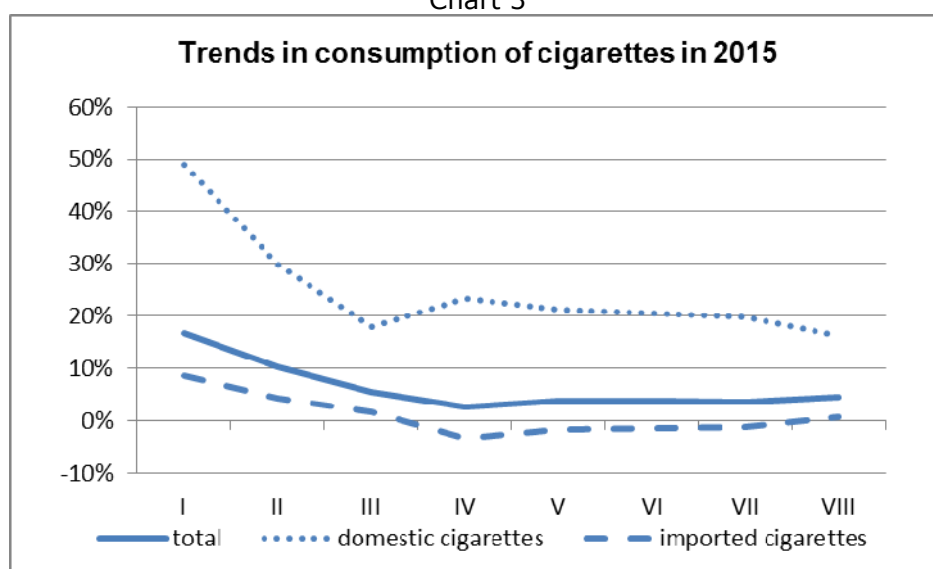
Chart 2



A drastic drop in consumption of fine-cut tobacco has brought a drastic decline in the share of this product in the tobacco market in B&H (Chart 2) from 7,4% which was for eight months of 2014, to only 1,1% in August 2015.

Positive trends from the last quarter of 2014 continued on the market of cigarettes in 2015. In contrast to 2014 business policy of domestic tobacco industry finally moved from cut tobacco to production of cigarettes. Using various marketing strategies domestic companies have significantly increased their investments. Monthly growth in consumption of domestic cigarettes, measured by the number of stamps issued, in the first quarter of 2015 ranged from 20 to even 49%, and has since stabilized at around 20% (Chart 3). A downward trend in consumption of domestic cigarettes has already been noticed in August (growth of 16,2%), which can be associated with higher base for comparison in that month, which included the effects of amendments to the Law from August 2014. Trends in consumption of imported cigarettes are much more stable, and growth in only first three months of 2015 was positive. From initial growth of 8,6% a decline in consumption was recorded in April, which was held until August, when a modest growth of 0,7% was recorded.

Chart 3

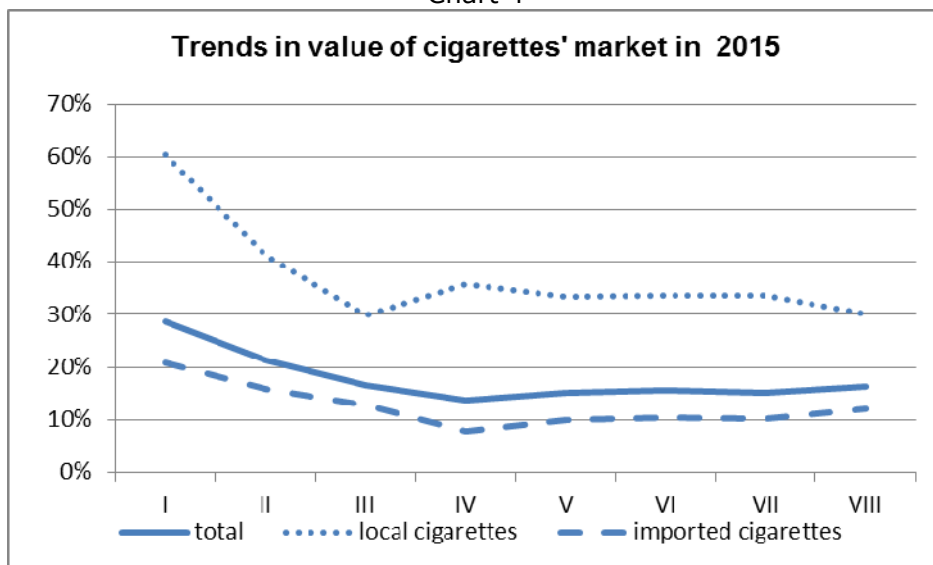


Thanks to the growing trend in consumption of domestic cigarettes total trends in consumption are positive. After the initial strong growth in consumption of 16,8% since April 2015 the growth has been much more moderate and stable, ranging 2,5 – 4,5%. Such trends are a surprise given the increase in excise rate at the beginning of 2015 and the concept of price elasticity of goods. With this in mind, it can be concluded that the growth in consumption is a result of two factors:

- (i) Excise policy that discouraged the consumption of tobacco and
- (ii) More effective controls of the ITA and the control over the tobacco market in terms of detecting illegal plants for cigarette production as well as smuggling and trafficking tobacco and cigarettes.

The share of cigarettes in the value of tobacco market has increased significantly in 2015, not only in the percentage but also in nominal terms (Chart 4). In the first quarter of 2015 strong growth of even 60% (domestic cigarettes), i.e. 30% (imported cigarettes) was recorded. There has been stabilization since April. The growth of the market of imported cigarettes is around 12% and domestic 30%. Faster growth of the domestic cigarette market brought the recomposition of the market structure, so that domestic cigarettes increased their share in the total value of the cigarette market from 22,9% to 25,6%.

Chart 4



Described trends in the cigarette market, especially certain recomposition in favor of domestic companies, are also the result of changes in operating policies and pricing strategies. Given that the domestic industry produces brands from the lower price group it is expected that the weighted average retail selling price of domestic cigarettes is lower than the weighted average retail selling price of imported cigarettes. The increase in excise tax rate at the beginning of the year always causes doubts whether the additional tax burden (excise + related VAT) will be fully passed on to the customer through higher retail selling prices or the company will bear a part of it on the burden of its profit.

Chart 5

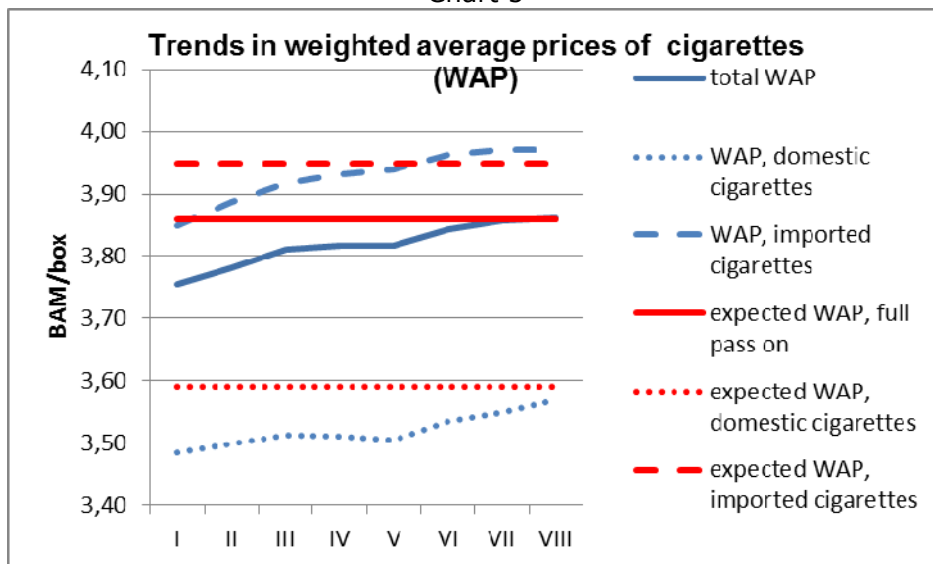
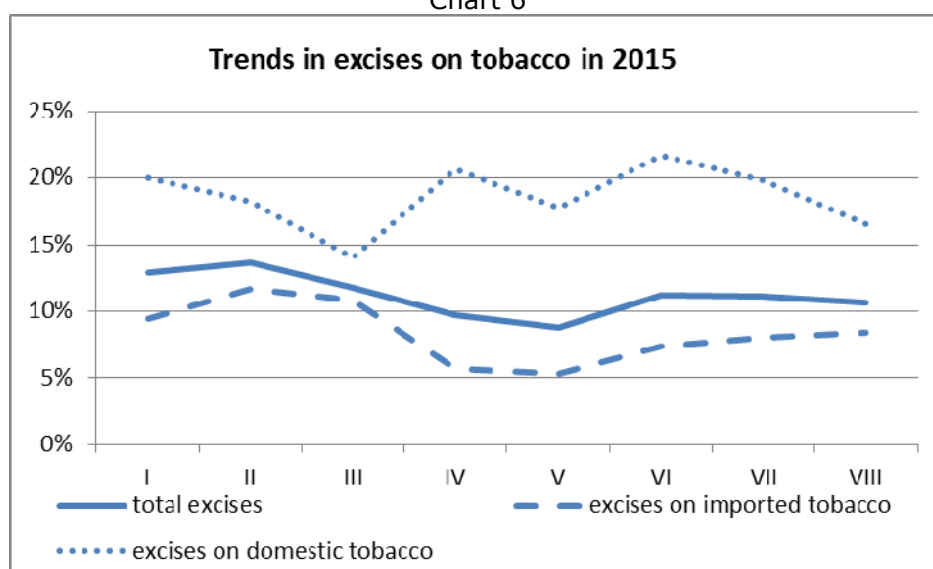


Chart 5 shows that the movement of the weighted average retail price of cigarettes for eight months was mainly below the expected weighted price that implies shifting a new tax burden entirely. It is obvious that during a large part of this year companies placed cigarettes at the expense of their profit. Domestic industry is still below the expected prices, while importers,

however in the last two months increased the prices to recompense for their losses. The policy of importers, due to higher weights, has brought the overall weighted average price of cigarettes in B&H at the expected level (Chart 5).

In eight months of 2015 there was a high and stable growth in revenues from excise duties on tobacco products of 10,6%. During the year strong fluctuations occurred in the monthly collection of excise duties ranging between 4% and 22%. Positive trends in the market of domestic cigarettes (growth of taxable consumption, rise in value of the market) also brought significantly faster growth in revenue from domestic excise duties, which increased by 16,6% in eight months, but with the downward trend of growth. On the other hand, revenues from excise duties on imported tobacco products have fluctuated strongly, and within the period of eight months they remained at 8,4% with the upward trend of growth. The share of revenues from excise duties on fine-cut tobacco is insignificant and amounts to about 0,8%.

Chart 6



It can be concluded that trends in taxation of tobacco products in the year to date have largely been determined by changes in taxation policy of fine-cut tobacco, which has to the minimum reduced substitution, legal and illegal, of cigarettes with fine-cut tobacco.

In general, the final range of migration of consumers from consumption of fine-cut tobacco to consumption of cigarettes, and thus the extent of the effects of amendments to the Law, is determined by several factors:

- (i) Regular income available for the purchase of cigarettes;
- (ii) The existence of other sources of income (from the gray economy, remittances, etc);
- (iii) The excise policy of the state;
- (iv) The growth of the economy;
- (v) The business policy of tobacco companies (prices, brands).

Naturally, of great significance are also continuing investigations into tax frauds, measures to prevent smuggling and trafficking and effective market surveillance. Given the low employment rate, stagnating wages of employees and slow economic growth, the expected increase in excise duties on cigarettes at the beginning of 2016 and, possibly, the introduction of a dedicated excise duty on cigarettes will be a strong pressure on the strengthening of the black market of tobacco, which can significantly derogate effects achieved by amendments to the Law.

## The effects of amendments to the Law on Excise Duties on taxation of beer

(Author: Dinka Antić, PhD)

*Amendments to the Law on Excise Duties in the field of beer are applicable from 1<sup>st</sup> of September 2014. Changes include the introduction of differentiated rates of excise duties on beer depending on the volume of annual consumption in the previous three years. The current standard rate of the excise duty of 0,20 KM/l becomes the lower rate, and the higher rate of excise duty is 0,25 KM/l. Bearing in mind the legal threshold of annual production and other conditions to exercise the right to a lower rate of excise duty it can be assumed that the lower rate applies on domestic beer and the higher one on imported beer. The Unit assumed while making revenue projections that differentiated excise duties would lead to substitution of imported brands of beer with domestic brands, of course, if the additional tax burden (excise duty + VAT) is transferred to the buyer through the price.*

### Trends in 2014<sup>3</sup>

Trends in the beer market in B&H in the period before the introduction of differentiated rates (2006-2013) showed the following:

- The quantities of beer imported in B&H and placed on the market were reducing from year to year. Compared to a maximum from 2008 the quantities of beer have decreased by 15% before the amendment to the Law;
- The structure of the market in terms of share of local breweries is increasingly deteriorated. The share of local breweries from a maximum of 42% dropped to 35,3%;
- Reduction of the taxable amount of beer led to a reduction of excise revenues, which from a maximum of 48,4 million KM decreased to 41,9 million KM.

Amendments to the Law have changed the mentioned trends already in the first four months of the application in 2014:

- The import of beer was increased by 11,2%, but still it was not enough to improve the negative trends in 2014 before the adoption of amendments to the Law;
- The effects of differentiated rates on domestic beer consumption have emerged only in November and December of 2014, when the amount of beer placed on the market increased by 27% compared to the same period of 2013. This has confirmed predictions of the Unit that differentiated excise rates will bring the increase in domestic beer consumption, if, of course, importers do not bear the additional excise burden entirely at the expense of profit. Despite great bad depth from the previous months it was enough for slight positive growth in domestic beer consumption to be achieved in 2014. However, no increase in the amount of domestic beer could fix bad market position of local breweries that from year to year deteriorates. Notwithstanding the improvement in the last two months the share of domestic beer on the beer market in 2014 was only 33% which was a historical minimum;
- There has been strong growth in revenues from excise duties on imported beer, first as a result of the higher excise burden, and in the coming months as a result of increased imports. On the other hand, a slight increase in excise duties on domestic beer as a result of weak consumption growth at the end of the year, could not significantly improve the trends in the collection of excise duties on domestic beer, so the year 2014 ended with a deficit of revenues from domestic excise duties of 5,6% (after excluding collection of old debts from revenues collected).

<sup>3</sup> Analysis relating to the effects of the application of amendments to the Law on Excise Duties in 2014 is published in the Bulletin No. 114, January 2015, [www.oma.uino.gov.ba](http://www.oma.uino.gov.ba).

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*Trends in 2015*

In 2015 there was a continuation of positive trends from 2014. Chart 1 shows the monthly changes in the quantities of beer. Imported beer was subject to smaller fluctuations resulting in steady cumulative growth of 4,6% (Chart 2). Strong fluctuations were noticed in the amount of domestic beer which however did not substantially affect the positive growth trend of 12.2% in the first half of the year. However, in the last two months there was a drop in the quantities of domestic beer placed on the market, which cumulative growth of quantities of domestic beer reduced to 6%. Minor fluctuations in the quantities of beer from imports and local breweries, because of the opposite signs of oscillation, did not affect the overall growth of the quantity of beer in B&H which is around 5% for four months (Chart 2).

Chart 1

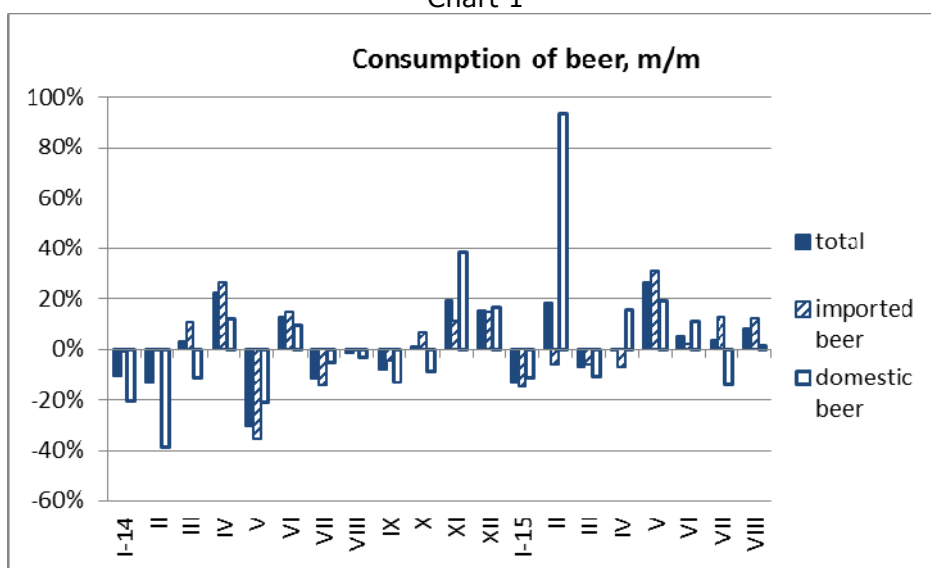
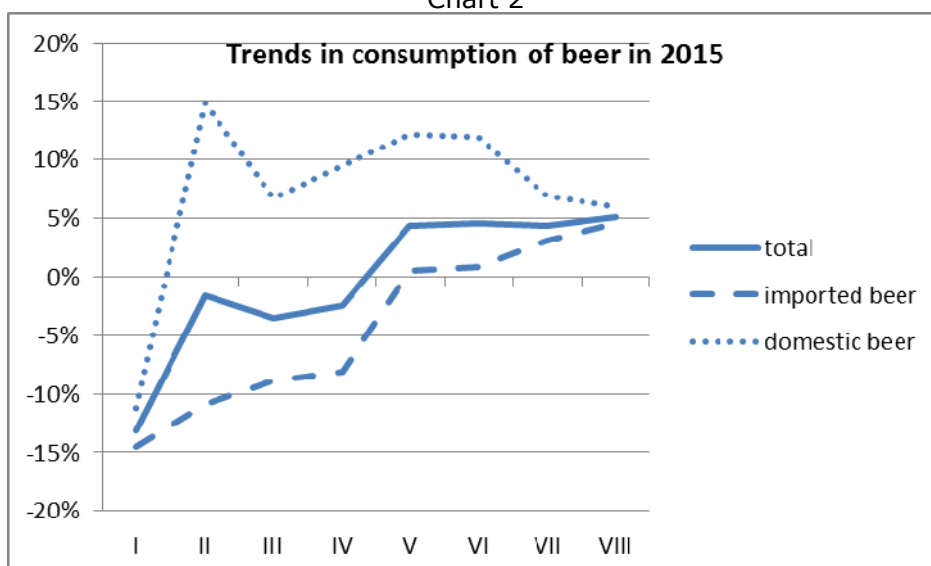


Chart 2



A growing trend in the quantities of beer also brought the growth in excise revenues. Chart 3 shows constant monthly surpluses in excise duties on imported beer. It was expected due to the

introduction of the higher excise duty rate. However, due to an unexpected increase in imports of beer the revenue growth exceeded the quantity growth, so an increase of even 30% was achieved for eight months (Chart 4). On the other hand, revenue from excise duties on domestic beer due to the unchanged excise policy followed the quantities placed on the market. In the first six months they grew to a maximum of 12,2% and then after the fall in the last two months they dropped to 5% of the growth. Ultimately, the growth in total revenues from excise duties on beer in eight months of 2015 amounted to even 20%. It should be noted that the collection of the old debt based on excise duties on domestic beer in the first quarter of 2014 was excluded from the base of comparison. As a whole, in addition to higher collection of revenues from excise duties the introduction of differentiated excise rates on beer resulted also in a slight improvement in the beer market structure. In eight months, the share of domestic beer increased to 34,3%, which is an improvement compared to the share of 33,9% for 2014.

Chart 3

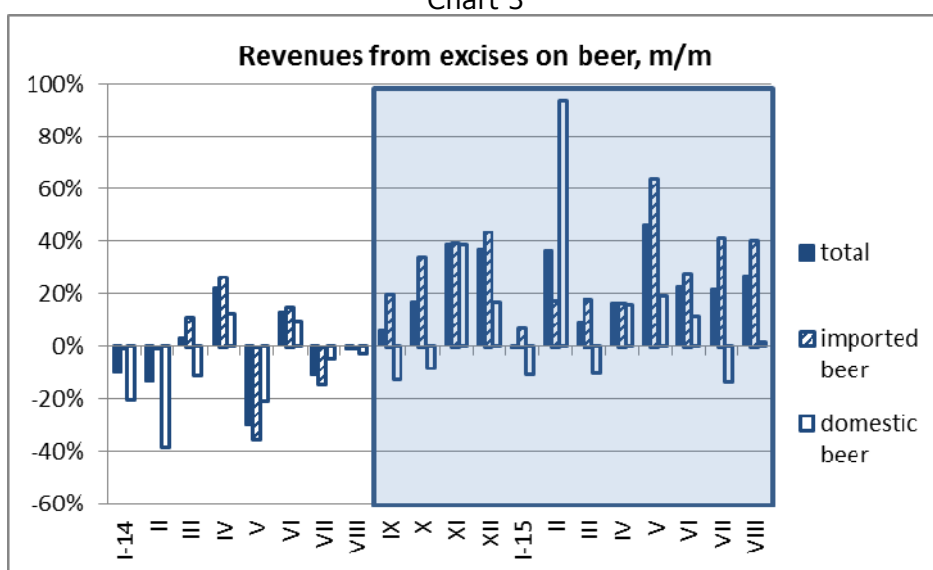


Chart 4

