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Cigarette and Tobacco Manufacturing Sector in the Economic System of Armenia and its Development Peculiarities

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ABSTRACT

The industry of Armenia, particularly the production of tobacco varieties has been studied in current prices and the price weighted index has been estimated in the current article. Tobacco plantations, gross yield and average yield capacity for 2014-2018 have been introduced per regions of Armenia. The production of cigarette and tobacco, import and export rates, the tariffs for the raw materials, as well as their types and sources have been described in tangible assets. The aim of the article is to emphasize the importance of cigarette and tobacco production in the economy of Armenia.

Introduction

The changes observed in the economy of Armenia in conditions of market economy are almost the same as they were in the former Soviet Union Republics: transition from state ownership to the private or mixed ownership relation, transition from the planned model of economic management to the market relations, from administrative pricing method to the supply-demand model, decentralization and liberalization of the labor

market, formation of an independent tax, fiscal and monetary policy, etc.

The tobacco and cigarette production sector is a traditional and rapidly developing sub-branch of Armenian economy, which is provided with both local and imported raw materials. The development rates of production sizes aren't so much related to the organization sizes. The production development is mainly related to such factors as the demand on the product, raw material provision, the position held in the market, quality of goods, etc.

Table 1. The share of tobacco production in the whole industry of Armenia*

| According to the types of economic activities Year | RA industrial product in current prices, mln AMD | Tobacco production types in current prices, mln. AMD | The share of tobacco product in the total industry, % |
|---|--|--|---|
| 2010 | 824430.0 | 16193.3 | 2.0 |
| 2011 | 998963.7 | 19888.6 | 2.0 |
| 2012 | 1121906.7 | 25420.3 | 2.3 |
| 2013 | 1242070.3 | 38306.7 | 3.1 |
| 2014 | 1291274.1 | 63112.2 | 4.9 |
| 2015 | 1342700.1 | 111544.3 | 8.3 |
| 2016 | 1432708.9 | 136288.6 | 9.5 |
| 2017 | 1664279.0 | 157747.2 | 9.5 |
| 2018 | 1737685.6 | 178367.8 | 10.3 |

*Annual yearbook of Armenia, 2019. Industry

Materials and methods

According to historical literature review tobacco growing hasn't been much developed in Armenia, while in the period of Soviet times the development of tobacco growing was only consumer-oriented. Nowadays, there are four large tobacco and cigarette producing companies in Armenia, namely "Grand Tobacco" LLC, "International Masis Tabak" LLC, "Masis Tobacco" LLC and "SPS Cigaronne" LLC, besides, the first mentioned three companies belong to Grand Holding, which is the largest corporation of Armenia.

To understand the significance of cigarette and tobacco production in the social and economic system of Armenia the data on the whole RA industry and tobacco production from 2010 to 2018 are presented in current prices (Statistical Yearbook of Armenia, 2019) in Table 1.

Here are the data on the RA industrial production per the types of economic activities expressed in percents for 2016-2018:

1. processing industry - 62 %,
2. electricity, gas, steam and air conditioning supply - 20 %,
3. mining industry and open pit mining - 16 %,
4. water supply, sewerage, waste management and recycling - 2 %.

Meanwhile, the share of tobacco products makes averagely 13 % in the individual structure of processing industry for 2016-2018.

The sector of cigarette and tobacco production (Decree of the RA Minister of Health Care, 2014) in the social and economic system of Armenia and its development peculiarities are depicted in Table 2, where the tax duties and revenues for the RA treasury and the share of each tobacco producing company in the state budget is introduced.

Table 2. The amount of taxes paid by the cigarette and tobacco manufacturing organizations in the RA and their share in the state budget, mln AMD (2016-2018)*

| Name of organization | 2016 | | 2017 | | 2018 | |
|--|-----------|-------|-----------|-------|-----------|-------|
| | mln. AMD | share | mln. AMD | share | mln. AMD | share |
| Masis Tobacco | 486 | 0.04 | 487 | 0.04 | 282 | 0.02 |
| International Masis Tabak | 9435 | 0.9 | 11388 | 1.0 | 13133 | 1.0 |
| Grand Tobacco | 22571 | 2.1 | 34751 | 3.0 | 42222 | 3.2 |
| SPS Cigaronne | 813 | 0.1 | 1303 | 0.1 | 2199 | 0.2 |
| Total | 33305 | 3.14 | 47929 | 4.14 | 57836 | 4.42 |
| RA state budget tax revenues and duties | 1078294.1 | 100 | 1156425.0 | 100 | 1306231.0 | 100 |

*State Revenue Committee of the RA

Table 3. Tobacco plantations, gross yield and average yield capacity for 2014-2018*

| RA regions/ marzes | Years | Plantations, ha | Harvested yield, centner | Average yield capacity per hectare, centner |
|-----------------------|-------|--------------------|--------------------------------|--|
| Ararat | 2014 | 124 | 4536 | 36.6 |
| | 2015 | 171 | 6761 | 39.5 |
| | 2016 | 95 | 2843 | 29.9 |
| | 2017 | 74 | 2968 | 40.1 |
| | 2018 | 129 | 3844 | 29.8 |
| Armavir | 2014 | 78 | 1814 | 23.3 |
| | 2015 | 43 | 1355 | 31.5 |
| | 2016 | 31 | 1067 | 34.4 |
| | 2017 | 39 | 678 | 17.4 |
| | 2018 | 35 | 750 | 21.4 |
| Lori | 2014 | 1 | 80 | 80.0 |
| | 2015 | 2 | 30 | 15.0 |
| | 2016 | 1 | 70 | 70.0 |
| | 2017 | 2 | 4 | 2 |
| | 2018 | - | - | - |
| Vayots Dzor | 2014 | 5 | 353 | 70.6 |
| | 2015 | 18 | 325 | 18.1 |
| | 2016 | 17 | 500 | 29.4 |
| | 2017 | 16 | 580 | 36.3 |
| | 2018 | 20 | 250 | 12.5 |
| Tavush | 2014 | 302 | 5745 | 19.0 |
| | 2015 | 332 | 6323 | 19.0 |
| | 2016 | 302 | 6509 | 21.6 |
| | 2017 | 282 | 5891 | 20.9 |
| | 2018 | 209 | 4296 | 20.6 |
| Aragatsotn | 2014 | - | - | - |
| | 2015 | 16 | 363 | 22.7 |
| | 2016 | 18 | 332 | 18.4 |
| | 2017 | 20 | 370 | 18.5 |
| | 2018 | - | - | - |
| Kotayk | 2014 | - | - | - |
| | 2015 | - | - | - |
| | 2016 | - | - | - |
| | 2017 | 27 | 376 | 13.9 |
| | 2018 | - | - | - |
| RA, total | 2014 | 510 | 12528 | 24.6 |
| | 2015 | 582 | 15157 | 26.0 |
| | 2016 | 464 | 11321 | 24.4 |
| | 2017 | 460 | 10867 | 23.6 |
| | 2018 | 393 | 9140 | 23.2 |

*Statistical bulletin, 2014-2018.

It is worth mentioning that all organizations engaged in the entrepreneurial activities of cigarette and tobacco production sector in the territory of Armenia are involved in the list of 1000 large taxpayers annually published by the State Revenue Committee of Armenia (petekamutner.am).

The cultivation of highly productive tobacco varieties adapted to the local conditions and producing high quality raw material is of utmost importance for the development of tobacco growing. In Armenia both common tobacco (*Nicotiana rustica*) and the Turkish yellow tobacco have been cultivated, which have been used mainly in local organizations as a raw material. The occupied territories for tobacco growing, their gross yield and average yield capacity both in the whole republic and in individual regions are of particular interest. In case of identifying these indicators we can have a clear picture about the role of cigarette and tobacco production in the social and economic system of Armenia.

The data of table 3 show that only several regions of Armenia are engaged in the tobacco growing. This is a serious problem in respect of raw material production.

The functionality of any industrial branch in the national economic system of each country, including Armenia, consists in the fact that, for example, the economic entities engaged in the entrepreneurship of cigarette and tobacco production in Armenia, purchase raw materials and supplementary accessories from the partner countries presented in table 4.

Table 4. Types and sources of raw materials needed for tobacco production*

| Type of raw material | Source of raw material |
|---|--|
| Tobacco raw material | Armenia, Iran, Greece, Bulgaria, Brazil, Republic of South Africa, South America |
| Aromatic mixture for tobacco production | Germany |
| Tobacco paper | Austria, France, Italy, Indonesia |
| Acetate filter | Armenia (Grand Tobacco), England, Italy |
| Tobacco filter paper | Austria, France, Italy |
| Tear strip | Germany, Czech Republic |
| Folding box | Armenia, Iran |
| Glue | Armenia, Iran |
| Aluminum foil | Greece, Armenia |
| Cardboard | RF, Turkey |
| Tobacco carton patterns | Turkey |

*grandtabak.com

Results and discussions

It is clear from the data of table 1 that parallel to the growth of overall industrial production sizes in the RA, manufacturing of tobacco product types and its share in the whole industry also grows up. Every year the same growing rate is recorded also in individual processing industries. In 2010-2018 manufacturing rate of tobacco products increased in 11 times, while its weighted index in the whole industry of the RA amounted to 10.3 % instead of previously recorded 2 %.

According to the data published by the State Revenue Committee in 2016, 2017 and 2018 “Grand Tobacco” held the second position in the taxpayers’ list, staying behind the company of “Gazprom Armenia” in 2016-2017 and the “Zangezur Copper Molybdenum Combine” in 2018. In the table 2 we can see the dominant share of tobacco producing organizations in the total weighted index of tax revenues and duties collected in the RA state budget. This circumstance is related not only to the production sizes of the given company and the income taxes paid from the salary of numerous employees but also to the current value-added tax and to high interest rates of excise tax (Parsyan, 2017).

Surely, tax receipt in the state budget is important but it is also a great problem for the organizations engaged in the mentioned sector. For example, in 2017 and 2018 the company of “SPS Cigaronne” LLC failed to make any investments for its production and economic activities due to high tax burden.

Besides, it is obvious that the greatest number of tobacco growing plantations is found in the Tavush region. On the average, 60 % of tobacco product is grown in Tavush. It should be mentioned that the yield capacity is not very high here. Thus, related to the peculiarities of climatic conditions, the region of Tavush provides continuously average yield capacity.

In 2017, 27 hectare tobacco was grown in Kotayk region for experiments but it was interrupted almost immediately after the start of the experiments because of high costs and low yield capacity. No other region is engaged in the tobacco growing except of those enlisted in the table. In 2018 tobacco growing activities were also interrupted in the regions of Aragatsotn and Lori. Throughout 2014-2018 the areas allocated for tobacco growing were reduced by 50 %. In Vayots Dzor the number of tobacco growing plantations and their productivity grew up to a certain extent in 2016-2017, but against the yield capacity recorded in 2014 it was only 51.4 %, while in 2018 it declined in about 3 times.

Summing up the data of table 3 and studying the tobacco growing plantations, gross yield and average yield capacity per regions for 2014-2018, we can state that in 2015 the tobacco growing plantations grew up by about 18 % comparing with the same index recorded in 2014, while starting from 2014-2016 they were reduced by 25 %. The yearly reduction of the plantations still goes on. In 2018, the tobacco growing plantations were reduced by 23 % against those recorded in 2014, nevertheless, the yield capacity stayed in the same level. The obtained indices serve as a warning alarm for the economic entities engaged in the mentioned sector, since only the skeletal (nuclear) raw material of cigarette is cultivated in the territory of Armenia.

It is possible that the monopsony market of the cigarette raw material has had its negative impact on the mentioned sector. For example, in 2000 the company of “Masis Tobacco” used to purchase 1 kg raw material with AMD equivalent to 1.2-2.5 US dollars. This raised interest among the raw material producers for increasing the production sizes. As a result, the market supply rate for cigarettes grew up and the buyer, taking advantage of his/her monopsonic position, reduced the prices down to 0.8-1.0 US dollar for one kg raw material.

Under such circumstances, there was no other way for the sellers than to comply with the situation. They had to sell own product with production prices, gradually reducing the plantation areas afterwards. Thus, the RA State Committee for the Protection of Economic Competition should take steps not allowing the processing organizations to set low monopsonic prices for raw material purchase (Khachikyan, 2010).

It is important to pay attention particularly to the land areas of Syunik region, RA and those of the Artsakh Republic, where tobacco growing was widely spread in the times of Soviet Union. In recent years certain measures have been taken in Artsakh to develop the tobacco growing branch, which was previously a rather leading sector of its industry. Anyhow, there aren’t any precise statistic data for recent times. The number of tobacco growing plantations are continuously changing there. Besides, together with tobacco growing a number of serious and important issues related to its storage and preservation terms appear. A need for additional investments appears, which should be in the focus centre of government and private sectors.

Among the serious problems for cigarette and tobacco production, those related to the purchase of high-quality seeds, lack of special driers, irrigation problems and issues of plant protection from insects have been identified.

Conclusion

Almost all regions of the RA were engaged in tobacco growing in 1980. Both aromatic and skeletal tobacco varieties were cultivated then and about 17000 tons of raw material was produced, but today the situation is quite different: in 2014 its production amount made 12 528 c, in 2015 it made 15 157 c, while in 2018 it fell down to 9140 c.

In the national economic system of the RA, the organizations engaged in the entrepreneurial activities of the cigarette and tobacco production are carrying out intensive production and economic activities, they factually meet the internal market demand and have already great success abroad. Investigating the development dynamics of cigarette and tobacco production in Armenia the significance of the mentioned industrial branch becomes obvious. Cigarette is the most exported finished product in Armenia, which has a great share in the total range of exported products. The exportation size is also sustainably growing up. About 85 % of cigarette and tobacco products are manufactured for exportation.

The organizations engaged in this sector usually face the problem related to raw material and accessory material provision. Some accessories necessary for the cigarette production are produced by local organizations so as to be independent of foreign market. Anyhow, they purchase raw material and other necessary materials mainly from abroad irrespective of the fact that the tobacco varieties of “Virginia”, “Burley” and “Samson”, which are high quality raw materials for cigarette production, are cultivated also in Armenia.

The delay or interruption of raw material supply, fluctuations of raw material prices, run out of the raw material reserves after a while, seasonal road obstructions and geographical blockade very often cause temporary termination in tobacco production. This is a very actual and concerning problem in terms of further development of the cigarette and tobacco production sector.

The solution of the problem related to organizations' provision with local raw material can be found in attempts to stimulate the farmers and rural farm households to practice tobacco growing. Anyhow, the monopsonic price policy in the raw material market retards this process. In this

circumstance the RA State Committee for the Protection of Economic Competition should take steps not to allow the processing organizations to set low monopsonic prices for raw material purchase.

The organizations of the given sector also have serious problems in terms of social awareness, which is related to the bans on cigarette and tobacco advertising (RA decree on “Advertising”, 2014). The organizations are unable to introduce their own product to the consumer. Particularly, providing information on the new product varieties has become a great problem. The organizations in majority cases use indirect advertising methods, i.e. charity events, participation in national and international exhibitions, etc.

The cigarette and tobacco producing organizations in the RA also have problems related to state regulation events. It is necessary to propose systemized and ad hoc solutions for the state regulations of the entire economy and individual sectors of the enterprises. For instance, the taxing mechanisms effectively operating in one branch shouldn't be applied for the whole economy. Moreover, each country has weaknesses and strengths peculiar to its own economy, thus, Armenia has a rather rich land and labor resources for the cigarette and tobacco production and the role of the state is to regulate (support) the poorly developed sectors of the relevant enterprises through direct and indirect leverages and enable the developing and developed enterprises to efficiently operate in the local market and not only to satisfy the demands of internal consumers but also succeed in the foreign market.

The cigarette and tobacco producing organizations of the RA have a serious problem related to staff recruitment as well. Lack of skilled and professional specialists results in periodic vacancies and thus, in the need to recruit new staff, which implies extra costs for their education and trainings.

So, despite the fact that cigarette and tobacco are considered to be products posing public hazard, Armenia has the needed assets for the development of the mentioned production sector. The current organizations of Armenia work with profits and as of 2018 they provide 10.3 % of the whole industrial product and 4.4 % tax returns to the state budget. Thus, Armenia has land and labor resources, as well as real and potential reserves for the development of tobacco production.

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