Privatization of State-Owned Tobacco Enterprises in Armenia

Contents

1. Introduction

According to the Natural Remedy Center of Armenia, 40-70% of the registered mortality cases from various illnesses are due to smoking. Annually, approximately USD 4 million is spent in Armenia on the purchase of cigarettes, and about 50-70% of all the expenses of the healthcare system are spent on the illnesses somehow related to smoking. As stated by the National Statistical Service, only 29% of men and 1.24% of women smoke in Armenia. The results of the National Tobacco Control Program research of the Ministry of Health showed 50% and 39.6%, accordingly. Taking into consideration everyday experience and the high rate of tobacco-related mortality, the latter appear to be more realistic, yet being less comprehensive.

Around 1.1 billion people worldwide smoke, and, with current trends, the number is expected to rise to more than 1.6 billion by 2025. In high-income countries, the number of smokers has, overall, been declining for decades, although it continues to rise in some population groups. In low- and middle-income countries, by contrast, cigarette consumption has been increasing.

The global shift towards trade liberalization facilitated by multilateral trade agreements, regional and bilateral agreements encouraged the penetration of tobacco multinationals into new markets. Emerging markets, being flooded with imported production, which, in initial stage is normally more qualified and attractive, than the local production, face the necessity to adjust local tobacco control policy parameters in order to withstand the consequences of the increased supply of tobacco products. Given such circumstances, the policy making, nevertheless, is less oriented to tobacco control measures, as the economic environment, on the other hand, sets other, more important targets.

The privatization, which in emerging economies accompanies the trade liberalization, particularly makes suitable environment for investments in tobacco industry. The result is competition in price and quality, both expected to cause an increase in consumption.

So for the emerging markets, having a serious increase in tobacco products supply on one hand, and still inadequate tobacco control policy on the other, the liberalization process could be expected to result on the growth of final consumption of tobacco. This highlights the need for a stronger national regulatory environment for tobacco control and better understanding of the influence of these processes on the economy.

Anyway, one can hardly be unprejudiced upon positive or negative effects of liberalization and privatization processes in tobacco industry, as the processes obviously have dual impact on the society: perspectives of gaining potential for further economic growth are accompanied with the negative health impact caused by the increase in smoking prevalence of population. The need to have a better understanding of processes ongoing in the mentioned sector is becoming more and more crucial.

To discuss the details of changes in tobacco industry of Armenia after the privatization period, one should not forget that in this case tobacco enterprises operate in a country with an economy in transition. It means that free market and market institutions are still in the process of formation. Legislation, including tax legislation is undergoing frequent changes. The detailed study of the post-privatization period activity of those enterprises also comes to prove the initial impact of those changes on their activities. As such, this paper compares the efficiency of the cigarette enterprises in pre- and post-privatization periods.

The paper examines pre- and post-privatization production levels, market shares and cigarette consumption trends, looking specifically at changes in technology, marketing and distribution introduced by private owners. The possible effect of privatization on the price of cigarettes is discussed. The paper tries to answer such questions, as: Comparing the periods before and after divestiture, which significant economic variables changed? Did privatization process increase consumption? Did quality and distribution improve? What happened to product prices?

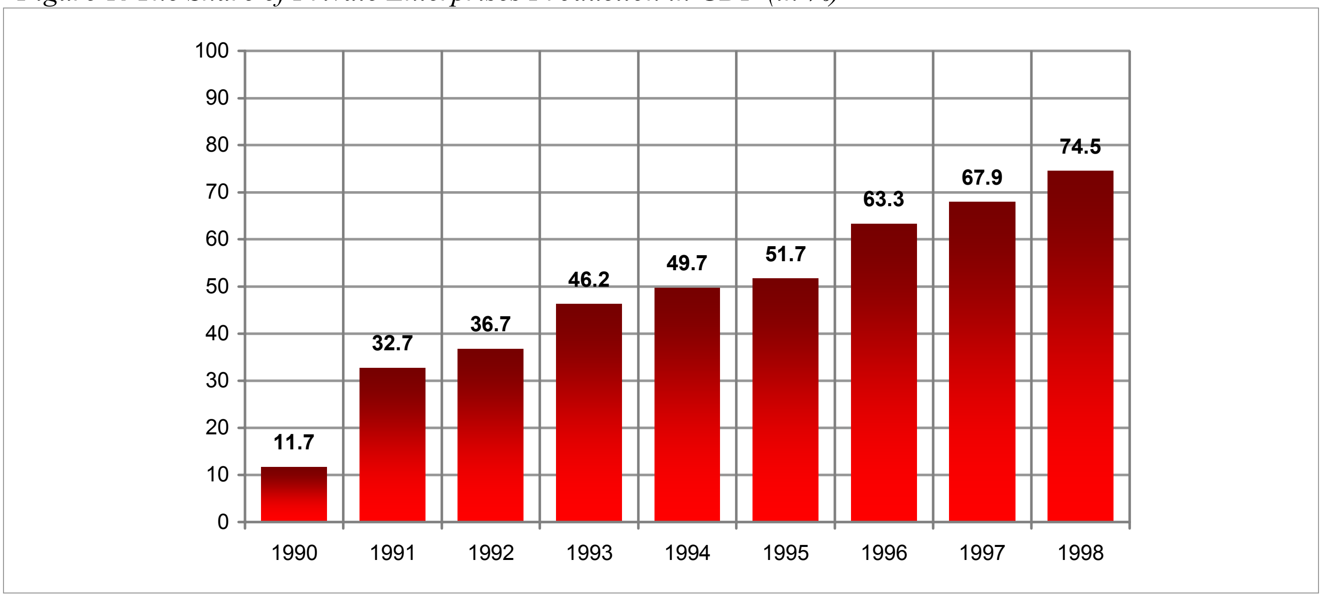
The purpose of this paper is to examine the impact of privatization on the tobacco industry from a broader perspective, taking into consideration economic factors, and their impact on different interest groups: the state, the producers and the public. Particularly, this is the first attempt to create the Armenian case of the tobacco industry privatization.

2. Background

2.1. Overall privatization in Armenia

Privatization was a key component in the Armenian economic reform policy throughout the 1990s. Privatization of agricultural land, as well as sales of small businesses is essentially completed by now. Over 1,500 medium and large companies were sold (over 65 % of the total), mostly through a mass privatization program. Today the private sector of the economy produces more than ¾ of the country's GDP.

Figure 1. The Share of Private Enterprises Production in GDP (in %)



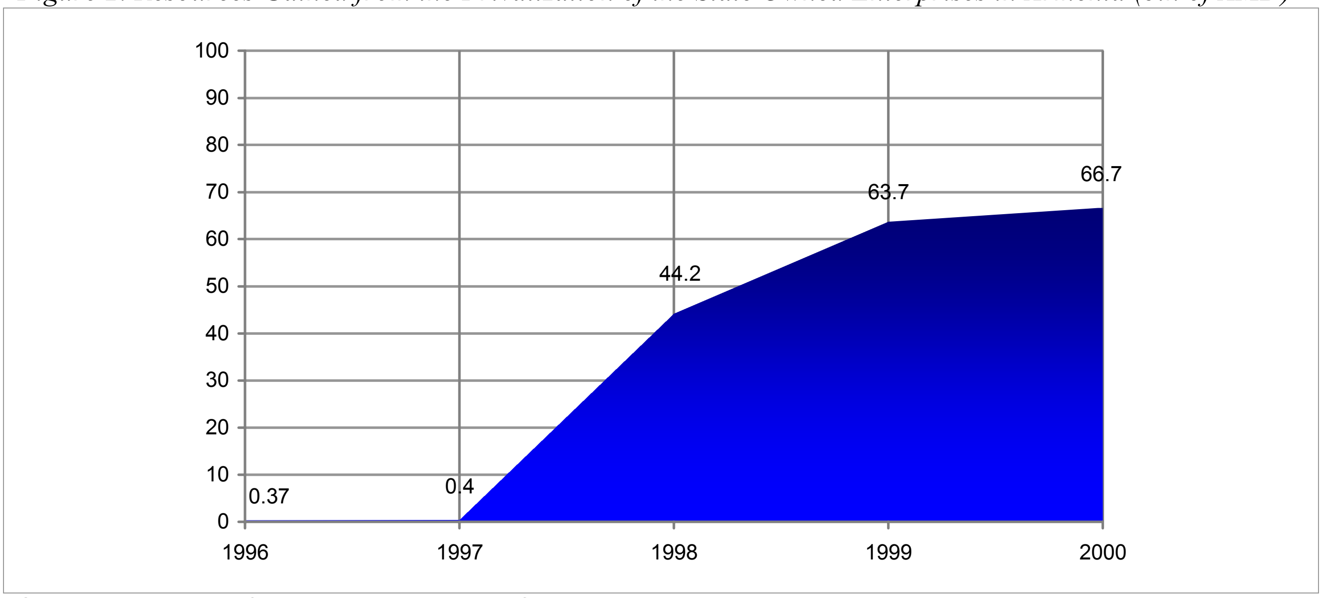
Source: The final report of "National Development Agenda" project of UNDP

Until mid-1997, the major goal of privatization in Armenia was to make structural changes in the economy and provide necessary preconditions for the transition to market economy. This was probably the reason why Armenian Government chose the extensive direction, mainly trying to "break" the predominance of state property and to create private owners' strata in the economy. The efficiency aspects of this process were considered secondary to the goal of switching from public ownership to private. Consequently, this was the reason why at that stage there were neither significant price, nor mandatory post-privatization investments requirements imposed by the Government on the potential investors. This was exactly the case with ArmTabak (the only state-owned tobacco company in Armenia) privatization in December 1, 1995 (the detailed description of this transaction is given below).

In the overall economic context, the privatization process affected both the structure of Armenian economy and the development of specific sectors. The end of the first stage of the privatization in the Republic of Armenia was marked by the completion of voucher privatization. Since 1997 the monetary privatization was initiated in the country. Privatization transactions concluded before 1997 ensured the critical mass of business owners but did not secure efficient use of the acquired property. Thus, as there were no longer quantity problems, the quality aspects were emphasized. For the first time conditional form of privatization was used, which considered not a mass privatization but a separate privatization deal for each particular enterprise. From this point of view, starting from 1997, decrees were prepared which clearly stated the requirements of the Government of Armenia towards the business owners and potential investors. It referred to the capacity of production, number of jobs to be created or retained, social guarantees, limitations on space use, etc.

Due to the participation of foreign investors in the privatization process in 1998-2000, Armenia's Government received around 110 million USD from privatization of public enterprises. Large enterprises of telecommunication, alcohol production and services were privatized through international tenders. Here, in each particular case the feasible price ceiling was supposed to be submitted together with an efficient investment project and business plan by the bidders. Certain financial resources have been obtained in the outcome.

Figure 2. Resources Gained from the Privatization of the State Owned Enterprises in Armenia (bln of AMD)



Source: Ministry of Finance and Economy of RA

Privatization through international tenders was the most difficult step, taking into consideration the mentality of the Armenian public. Armenian society as a whole, like that of almost all post-socialist countries, could not accept easily the fact that foreigners would manage local property. It was a difficult step but an absolutely necessary one, because for the first time Armenia appeared as a country that could be of interest for international investors. Tender announcements about companies presented for international privatization in Armenia were published in international mass media. The world-famous companies expressed their interest to own and manage businesses in Armenia.

Currently the privatization process in Armenia entered its final phase. As mentioned above, it solved a number of essential problems, created necessary environment for future development of new market-oriented economic relationships, though it was not successful in some particular cases. In particular, the main achievements of the privatization process in Armenia were:

- elimination of the soviet type of management in business and economy as a whole;
- created the group of private owners in the society and set the ideology of private ownership, thus guaranteeing irreversibility of the economic reforms;
- opened the local market for the investors, thus making possible capital inflow to the country;
- made preconditions for healthy competition, which, in its turn, caused improvement of the quality of the production and decrease in price;
- provided serious revenues to the state budget, which gave possibility for the government to make capital investments in the economy
- redirected investments to correct sectors of economy, as the decision making moved from centralized state institutions to private investors, who are guided by the principle of making maximum profit;
- caused enterprise restructuring in various sectors of economy, thus resolving the problems of soviet-type inefficient enterprises.

Local and international experts carried out several researches on privatization in Armenia[1]. The aspects of efficiency, socio-economic impact, etc. were and are still being discussed. While there were studies examining the privatization process in thorough details including macro, fiscal and micro economic perspectives, no study or review of evidence was published that examines the impact of privatization of state-owned tobacco enterprises (and establishment of new private tobacco enterprises) in Armenia on the development of industry on one hand, and public health, on the other. It is evident that tobacco is a special case: tobacco is probably the only consumer product in the world that kills when used as intended. Due to the addictive and harmful nature of cigarettes and other tobacco products, examination of the impact of tobacco privatization is more complex than for other industries.

2.2. Country background: political, economic and market structure

The transition from one economic system to another – completely different one - was not smooth for Armenia. The country faced a number of hindrances on the way of economic reforms. After the collapse in the early 1990s, the economy began recovering slowly in 1994. Since then the economy has expanded at an average annual rate of five percent.

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1 CEPRA/IRIS. 1997. “Mass Privatization on Enterprises in the Republic of Armenia: An Early Assessment” Mimeo. November
Foreign Investment Advisory Service (FIAS). 2000. “Armenia: Administrative Barriers to Investment”. Washington, D.C.
Betra, Geeta and Andrew Stone. “The Business Environment in Armenia: Results from a Private Sector Survey”. Washington, D.C.
The World Bank Group. 2001. “Armenia – Growth Challenges and Government Policies”. Sector Report. Washington, D.C.
Ashot. Markosyan. 1997. “Management, Methodology, Strategy and Results of State Enterprises Privatization”. Yerevan, Armenia

In its initial stage the economic reforms in all the branches of economy could have been specified as extensive ones. It was dictated by the need to get rid of the legacy of the former economic system, incompatible with the principles of market economy. Once supposed to be a country with highly developed industry and social safety, Armenia shortly added the list of poor countries with numerous economical and political problems. As a result, output plummeted by some 54 percent over 1991-93 and inflation increased to over 1,200 percent during 1992, and further to over 10,000 percent in 1993.

While households' income in nominal terms grew by 1,367 times since 1990, in real terms it decreased substantially as consumer prices grew by about 22,111 times. As a result, the purchasing power of the population dropped by 16 times from 1990 to 1994. Starting in mid-1994, the Government implemented tight fiscal and monetary policies accompanied by broadly based structural reforms. Those policies have resulted in significantly lower inflation, and annual real GDP growth averaged 5.4 percent during the period from 1994 to 2000. Per capita income grew from US$173 in 1990 to US$503 by 2000.

Based on 1988 official figures, only one-fifth of the population was considered to be below the poverty line, defined as a minimum income per family of 78 rubles, equivalent to US$87 using the then official exchange rate. In the early 1990s, as a result of the socio-economic crisis, significant changes occurred in the structure of income and expenditures of the population. Socio-economic indicators have been constantly deteriorating and poverty increased. The survey conducted in 1996 by the Ministry of Statistics in cooperation with the World Bank, showed that the poor represented 55 percent of the total population, while the extremely poor constituted 28 percent of the total population. Though since then there has been no notable change in the share of the poor, as demonstrated by a similar study conducted for 1998/99, there has been a significant decrease in the share of the extremely poor - to 23 percent, which may be attributed to the introduction of a system of family allowances targeted at the very poor groups of the population.

The worsening of socio-economic conditions, although, did not stop the reforms process in Armenia. Privatization started in parallel with the rapid economic reforms and coincided with the mentioned negative changes in population’s welfare. Nevertheless, it could not be considered as a trigger of such changes. The majority of the companies that underwent the privatization process had previously exhausted all the resources to continue their activities, as the markets had already been closed for all the large companies, and the state budget failed to cover the fixed costs of maintaining the companies. So the privatization did not have a major impact on job loss. On the other hand, the mass privatization did not justify the hopes to create new workplaces, as the new owners of the enterprises did not always possess appropriate financial means to make investments for the restructuring or innovation of the enterprise. The second stage of privatization, certainly, brought serious financing for the state budget, which was mainly directed to capital investments. Yet, this stage of privatization did not have a serious impact on people’s welfare, similarly. Its main role and importance for the country was the structural change in overall economy.

Growth in the number of private companies was remarkable, occurring largely outside privatization process until 1997. From 1994 to 1997, the number of enterprises increased by more than 500 percent, from just over 5,000 enterprises to close 38,000 of which only less than 3,000 were newly-established publicly-owned enterprises. By the end of 1998, the total number of enterprises exceeded 41,000, of which 28,000 were still in public ownership. The informal – unregistered – sector has also grown fast. The overall picture of the sector is a myriad of recently created firms, of which the large portions are small companies. However, since then the pace of growth in the private sector showed signs of slackening, as the much of favored trading and services sector became saturated; and the remaining legal/regulatory and tax impediments discouraged investments in more capital-intensive manufacturing.

In recent years, despite macroeconomic stability, business environment remains fragile. The lack of legal infrastructure to fight the shadow economy often undermines fair competition. The black market is quite large. The shadow economy is estimated by the experts to make up 40 to 60 percent of the whole economy; the corruption level in Armenia is also quite high.

Nevertheless, Armenia's economy appears to be one of the most stable and liberal in comparison with other countries with transitional economy in the region and the trends towards its further liberalization and strengthening are in place.

3. Privatization of State-owned Tobacco Enterprises in Armenia

Tobacco in Armenia is being grown for more than 300 years. During Soviet times Armenia had developed a thriving tobacco industry. Armenian cigarettes were a sought-after product all over the Soviet Union for their superior quality and innovative designs. At its peak, in 1989, Armenian Tobacco cigarette factory produced almost 10 billion cigarettes a year.

However, with the collapse of the Soviet Union Armenian cigarette producers lost more than half of foreign markets and key suppliers. The transition from the Soviet-style command economy to a market economy made things even worse. Factory managers, accustomed to the system of central planning suddenly found themselves without the 'parental' guidance of GOSPLAN, (the State Central Planning Committee) and facing previously unknown problems, such as profitability, financing, marketing, and advertising.

Liberalization process opened the local market for the imported tobacco products. Foreign companies intensively entered the market and flooded it with their production. The demand for the high quality (as compared to the soviet brands) production, which, in addition, had more market oriented design and was properly advertised, rose substantially. Also, the fact that western brands had not been available for the population in soviet period made an extra increase in demand for these products. Tobacco products' imports had not been properly registered or declared to the tax or statistics authorities in early 90s so the proper image of the situation can not be properly represented by official statistics (for tobacco products' trade data see Figure 17 and Figure 18).

Along with liberalization of the tobacco market, large local enterprises like Armenian Tobacco, lacking both the expertise and market mechanisms for capital raising, virtually collapsed. In 1996, the cigarette production in Armenia dropped from 12 billion ten years earlier to just 200 million cigarettes. The local production was almost completely crowded out from the market.

This was the picture of the industry when the sector underwent privatization process.

The privatization of the only tobacco producer in Armenia – ArmTabak, was completed through subscription to shares. As the privatization took place in mid 90s, and could be described as one of the examples of voucher privatization, it contained no preconditions for further development of the company and no rehabilitation program or other investment liabilities. Thus, the new owners of the company were those, who managed to suggest enough quantity of vouchers.

On the basis of ArmTabak in 1997 a new company – “Grand Tobacco” joint venture - was founded by 3 founders: Armenian “RRR” ltd (33%), Armenian “Samsun” ltd. (33%) and Canadian “Grand Tabak” (34%). The authorized capital stock made up 400,000 USD for the latter and 8 million of US dollars have been invested in the company. The rationale for the new company was the involvement of foreign capital: as a joint venture with foreign capital Grand Tobacco enjoyed a more favorable tax environment. ArmTabak became much less competitive, and gradually its market share diminished. Nevertheless, as a result of privatization the tobacco industry in Armenia gained new capital investments; and this provided for revival and further growth of the industry.

It should be stated here that the mentioned period of privatization, as well as other economic activities in Armenia were not always traceable. The mass scale of privatization and the lack of practice of appropriate institutions caused improper organization of the process and could not manage to always provide the expected transparency. As a result, more detailed information on specific privatization contracts is not always available.

The case is analyzing the operation of pre- and post-privatization cigarette producing enterprises, which are ArmTabak, Grand Tobacco LLC, and SPS Cigaronne LLC.

ArmTabak was the only state-owned enterprise producing tobacco products in the former Soviet Armenia. It was privatized on December 1, 1995 and became an open joint-stock company. After that there is no any totally or partially state-owned tobacco enterprise in Armenia. Moreover new private tobacco companies were established.

Grand Tobacco Ltd. Armenian-Canadian JV began operating in July 1997. The Company produces large variety of cigarettes, acetate filters and exports tobacco. Already in 1998 the Company produced 2.2 billion cigarettes and the net profit made more than AMD 2 billion (about USD 3.8 million). Presently this company’s products have a significant market share in the local market of tobacco products.

SPS Cigaronne Ltd. was established at the end of 1999 and began operating in 2000. It produces an exclusively designed tobacco product, which is almost fully export-oriented. Less than 10% of the production is sold in the local market.

To have a full image of the Armenian tobacco market we should also mention the significant influence of imported tobacco products. Many well-known cigarette producers are present here such as **JT International, Philip Morris, Reemtsma, British American**

Tobacco and others. They came to Armenia with their rich marketing and sales experience, strong advertising capacity and excellent product quality. That, in turn, forced the local producers to strive to survive in competition.

3.1. Impact on Producers

3.1.1. Productivity

Privatization is widely expected to promote productivity and efficiency. The transfer of ownership of the single state-owned company to private shareholders, as well as emergence of new private tobacco companies significantly changed the management principles and objectives of the tobacco industry in Armenia.

The shift from planned to the market economy, where the private ownership of the enterprises is dominating and the enterprise owners are free to make business decisions on their own initiative and own risk, highly stimulates these managers to increase the efficiency of decision making. The manager in the planned economy is not personaly responsible for his decisons nor the supervision upon his activities is tight enough to impartialy judge over the rate of efficiency of the manager. Besides, such a system causes corruption, which, in its turn, eliminates non-biased appointments to the positions of the top managers of state companies.

Besides, due to the state budget constraints and the social policy of the Government, the primary mission of state owned enterprises is viewed as “maintaining the employment” concept. This brings to future emergence of unhealthy circles in the economy, and, as a consequence of their poor management, all problems artificially are put on the shoulders of taxpayers.

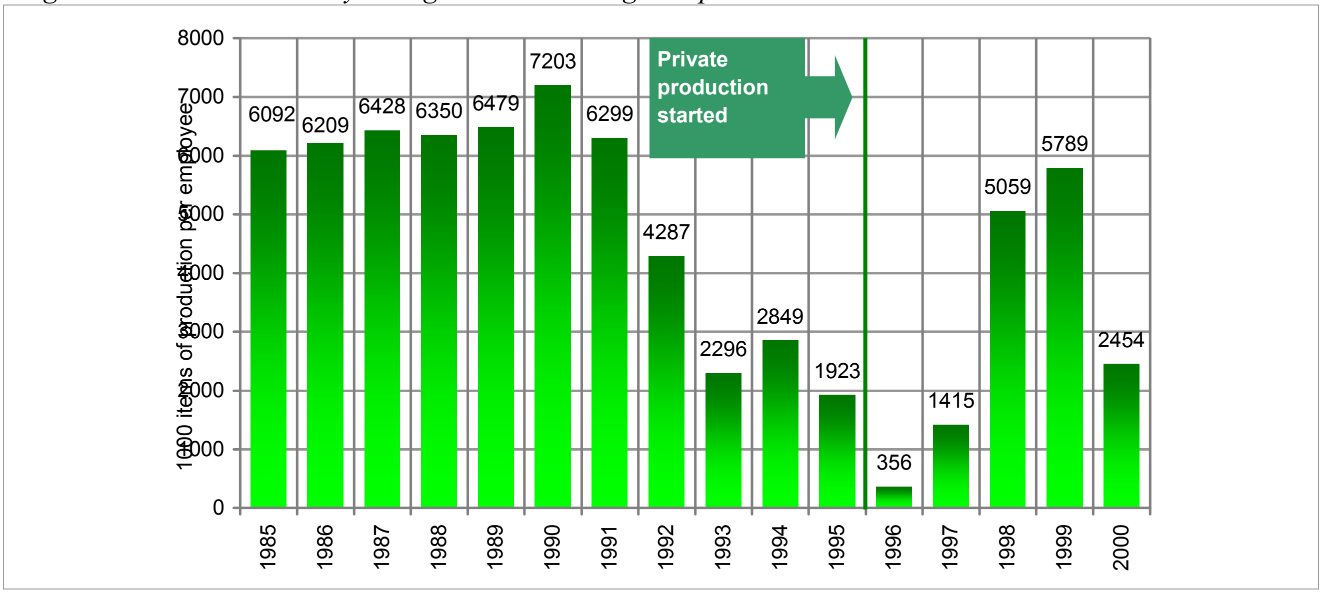
Instead of putting efforts to win new markets and maintaining their existing market share, as well as getting new technologies, the state-owned cigarette companies reduce quantity and quality of the production. Costs and expenditures exponentially grow and reduce revenues. So, the profitability just decreases year after year because no investment is made.

Besides, employees of state-owned enterprises are usually not motivated: they believe that if you work for one of those companies, no matter how good of an employee you are, there is a very little chance for advancement and very little chance for salary increase. No matter how much work you perform, you are probably not going to get very far. Whereas, the management of a private company will motivate good employees with higher salaries and promotion, so that they will be able to use those employees to the best advantage.

After the privatization in the cigarette industry in Armenia was completed and new private enterprises were established, namely, Grand Tobacco LLC, the average labor productivity in this sphere has significantly increased. In 1998 and 1999 already it exceeded the average labor productivity in 1990-1997 three to five times, yet remaining about 20% lower as compared to 1980s. As Figure 3 shows, in 2000 the output per employee decreased twice as compared to the previous two years. As it is shown further, the same decrease is recorded also in the total cigarette production in 2000. It occurred because of overall economic stagnation in Armenia in the first quarter of year 2000 caused by political crisis after the terrorist attack in Armenian parliament in October 1999. So, the decrease of output per employee in 2000 should rather be ignored in the overall trend.

The labor productivity in private cigarette enterprises is increasing, yet remaining in lower level as compared to pre-privatization period. The latter is conditioned by the fact, that during the planned economy the producers had no problems with sales, as the total production volumes were set by the state planning. So were the sales volumes. In post privatization period the producing companies conquered the local market, which is not very large, while the exports possibilities are limited, taking into consideration the tight competition in large markets and common restrictions for entering new markets.

Figure 3. Labor Productivity in Cigarette Producing Companies in Armenia[2]



Sources: National Statistical Service. Official Letter # 18-3-17, 22/10/2001,
Statistical Yearbook of Armenia - 1995,1996. Ministry of Statistics, State Register and Analysis. Yerevan 1998,
Brief Statistical Collection - 1995. State Department of Statistics, State Register and Analysis. Yerevan 1996.

3.1.2. Production

Starting from full privatization and establishment of new private cigarette companies, those enterprises constantly increased their production volumes and added new cigarette brands. While competing with high quality foreign tobacco brands, the newly established Grand Tobacco and SPS Cigaronne had to improve their production technology, labor productivity, marketing techniques, sales strategies, etc. As it was shown above, they managed to do so. Thus, Grand Tobacco's present annual manufacturing capacities amount to 6 billion cigarettes and 4 billion acetate filters. As a result, those enterprises succeeded in entering the market due to their aggressive sales strategy, as well. It should be stated here, that prior to privatization no sales promotion had been carried out in Armenia, alike other soviet republics. The advertisement campaign of local producers is visually much more aggressive and broad. Although there are no data on how much money these companies do spend on their advertising (these data are not disclosed to the public), it is obvious for an observer, that both the quality and the efficiency of local brands' advertising is higher. This refers to advertisement by TV and radio and also to the poster ads. Besides, the local producers stress on peculiarities of Armenian lifestyle, thus remaining closer to the consumer.

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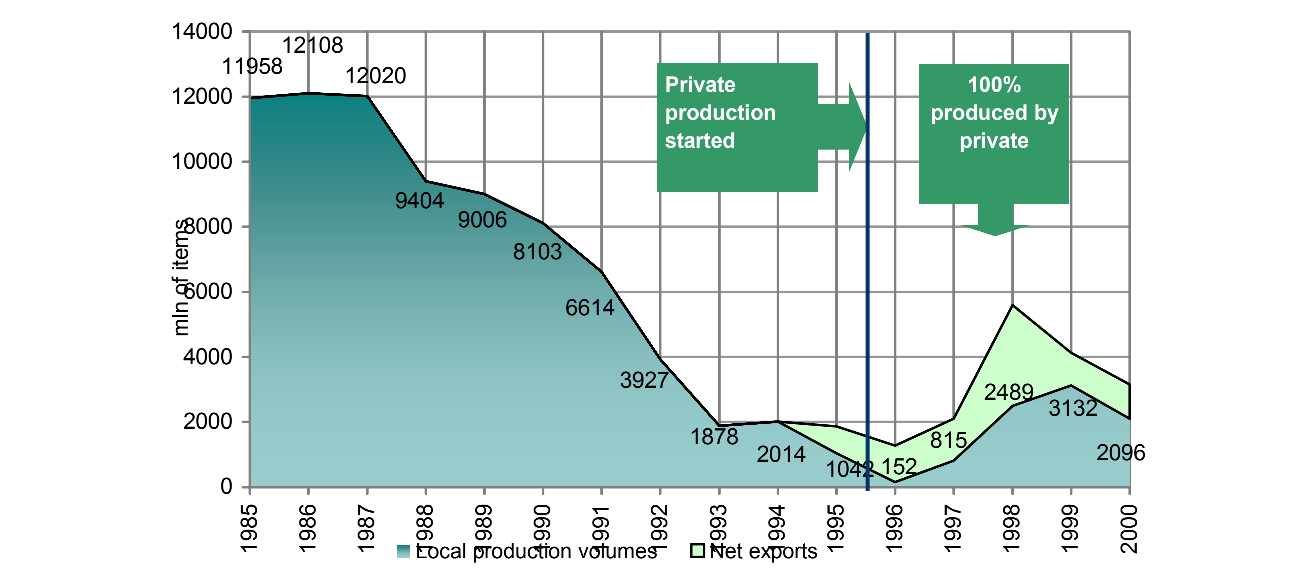
[2] 1985 – 1990 data are based on ICHD estimations (see Figure 8)

Figure 4. Pre and Post Privatization Cigarette Production in Armenia



Sources: National Statistical Service. Official Letter # 18-3-17, 22/10/2001;
Armenia Statistical Yearbook 1990, State Department of Statistics, State Registry and Analysis of the RA, Yerevan 1991;
Statistical Yearbook of Armenia - 1995,1996. Ministry of Statistics, State Register and Analysis. Yerevan 1998.

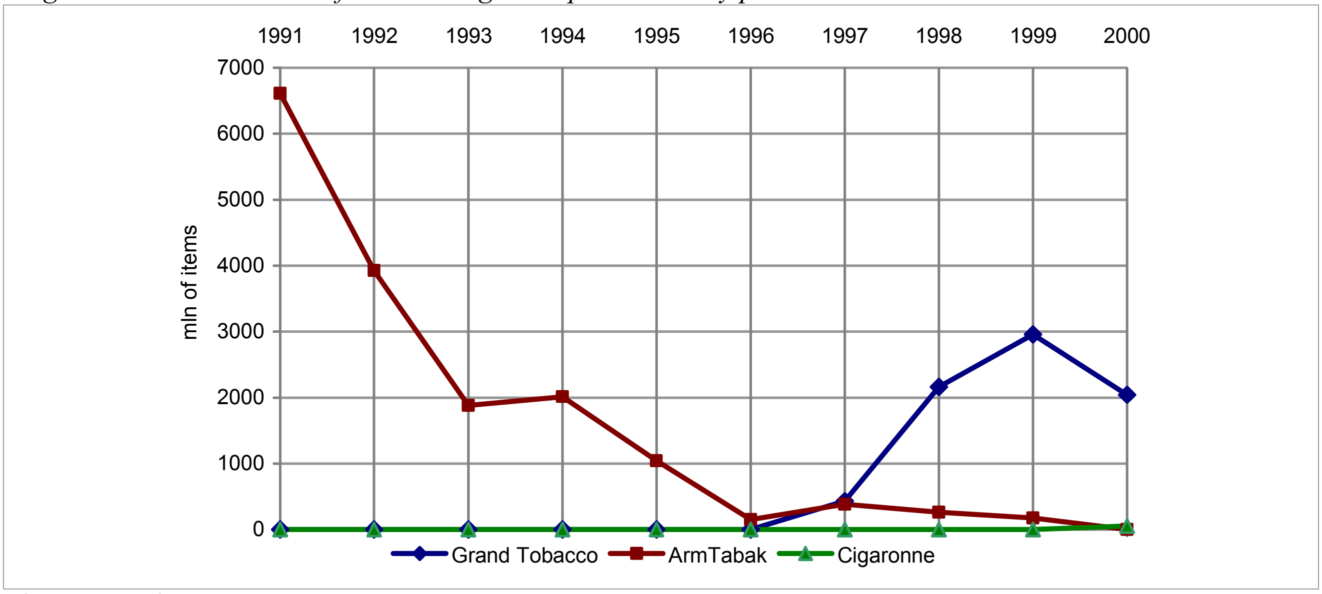
As observable in Figure 4, from 1988 the production volumes drastically decreased. 1988 was the year of breaking-off for Armenia. The irreversible process of breakdown of the planned economy started that very year. In addition, the devastating earthquake also happened to be in 1988, thus leaving few chances for the industry to keep its production volumes. The negative impact of the transition process is obvious on the chart.

It should be noted here, that Armenia happened to be a major net exporter of cigarettes during the soviet era. Almost 15 % of the locally produced cigarettes had been exported to other soviet republics. This means that local market previously absorbed fewer cigarettes than produced. The trade links, lost during the transition period, had not been recovered, as the new realities dictate their own conditions. Few factors, such as the decrease in social conditions of the population, a large scale of migration from the republic, the entrance of foreign competitors to the market negatively impacted on restoration of former volumes of the production (the “Net Exports” series in the Figure 4 indicate the share of the market occupied by the foreign brands).

After a prolonged decrease of cigarette production in Armenia prior to privatization, it significantly increased in 1999 by 1961% compared to 1996. This was obviously achieved due to both internal factors, such as labor efficiency, technology updates, new advertising strategy and so on, and also on several external ones, such as socio-economic environment and tax legislation changes. The positive shift in tobacco industry could be described as a consequence of privatization process, having in mind that the privatization itself was a result of the global changes in economy and these two processes coincided. The direct impact of the privatization could not be separated from the influences of overall reform processes in the economy, especially taking into consideration the fact, that the only state company – ArmTabak – has de facto stopped its activities.

At the same time, assessment of the present state of internal factors (in particular, huge production capacity due to improvements of technologies) allows us to predict further increase of production and sales volumes of those enterprises.

Figure 5. The breakdown of the total cigarette production by producers



Source: ICHD estimations

In 1997 – the year of starting production process in Armenia - the average monthly production of Grand Tobacco of total 12 brands made 39,595 thousand cigarettes without filters and 46,844 thousand cigarettes with filters, while in 1998 it made 65,483 thousand and 120,272 thousand of total 28 brands, respectively. Within its first two years' operation, Grand Tobacco Ltd. conquered a significant part of the Armenian cigarette market. The production in the Company was organized to avoid tangible dependence upon certain merchandise, despite the fact that production of certain brands was likely to increase the Company's profitability at a greater extent than the others. Presently the Company's brands share in the local market remains constant. Grand Tobacco also pays a great attention to exporting its production. Thus, already in 1999 its export volume made up to 87,094 thousand sticks. The annual production of Grand Tobacco in the past two years amounted to 20,365 thousand USD in 1999, and 19,137 thousand USD in 2000. Presently Grand Tobacco is considered one of three largest taxpayers in Armenia and the largest among private enterprises.

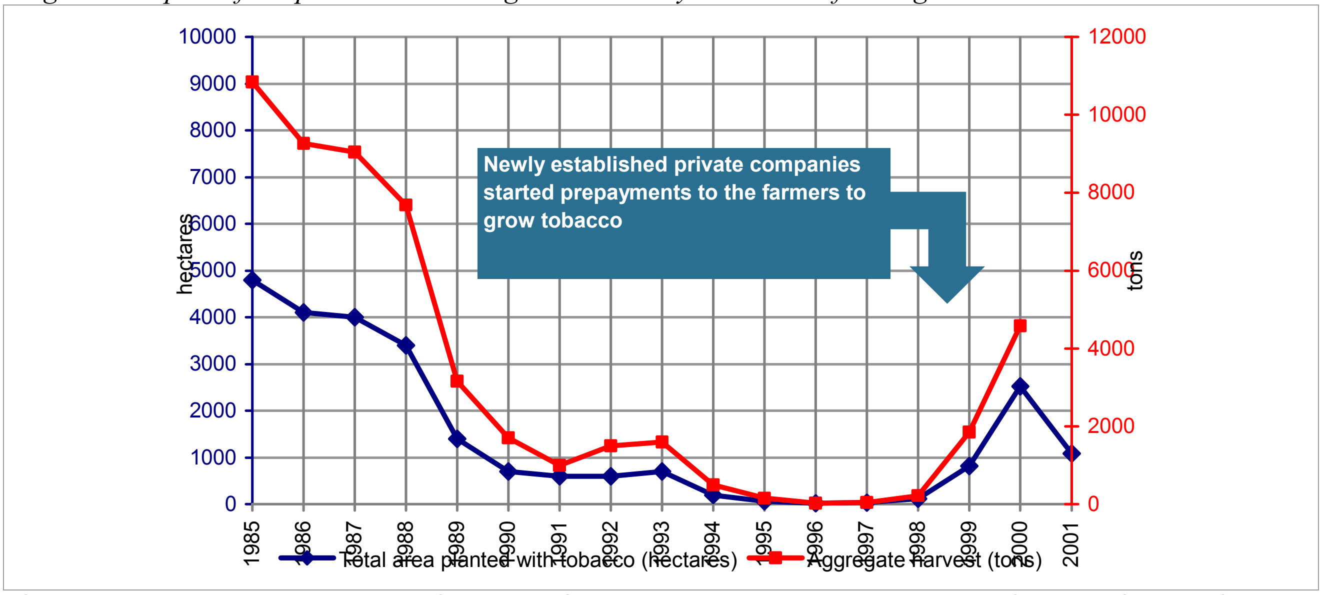
SPS Cigaronne is a relatively smaller enterprise that produces luxury premium cigarettes oriented to foreign markets. It produced 52 million sticks of cigarettes in 2000. Cigaronne is still expanding its sales outside Armenia, but already has its constant share in the local market.

3.1.3. Tobacco farming

There is also another effect of cigarette industry privatization in Armenia. The private cigarette enterprises became the cause of rehabilitation of once strongly developed tobacco farming in the country. They designed new methods of cooperation with farmers; particularly the farmers received prepayments and seeds for their future yield. Thus, the total area planted with tobacco and the annual aggregate yield significantly increased in the past three years. For instance, the aggregate harvest of tobacco leaves in Armenia increased by 2054% in 2000 compared to 1998.

Yet the share of tobacco in overall agricultural production remains low. The farmland cultivated with tobacco composes about 0.83%[3] of total farmland. The household involved in tobacco cultivation compose about 5.72%[4] of total households in the agriculture sector. It is worth mentioning that the total number of households involved in tobacco cultivation has increased more than 40 times, starting from 1995. The private cigarette enterprises became the cause of rehabilitation of once strongly developed tobacco farming in the country. They designed new methods of cooperation with farmers; particularly the farmers received prepayments and seeds for their future yield.

Figure 6. Impact of the privatization in cigarette industry on tobacco farming



Sources: "Agriculture in the Republic of Armenia": Statistical Yearbook 1990- 1999; National Statistical Service of the RA; Yerevan 2001;
Armenia Statistical Yearbook 1990, State Department of Statistics, State Registry and Analysis of the RA, Yerevan 1991.

The prepayment of the contracts in tobacco farming appears to be the major motivation for the shift of hundreds of household to the tobacco sector. Only few other agricultural products cultivation and production offers such an advantageous condition for the farmers.

It is worth mentioning that the imports of the tobacco leaves also grew in post-privatization period.

[3] "Agriculture in the Republic of Armenia": Statistical Yearbook 1990-1999; National Statistical Service of the RA; Yerevan 2001; National Statistical Service. Official Letter #18-3-17, 22/10/2001

[4] ICHD estimations for the year 2001

Figure 7. Imports of tobacco and aggregate harvest

Sources: National Statistical Service. Official Letter # 18-3-17, 22/10/2001
"Agriculture in the Republic of Armenia": Statistical Yearbook 1990-1999; National Statistical Service of the RA; Yerevan 2001

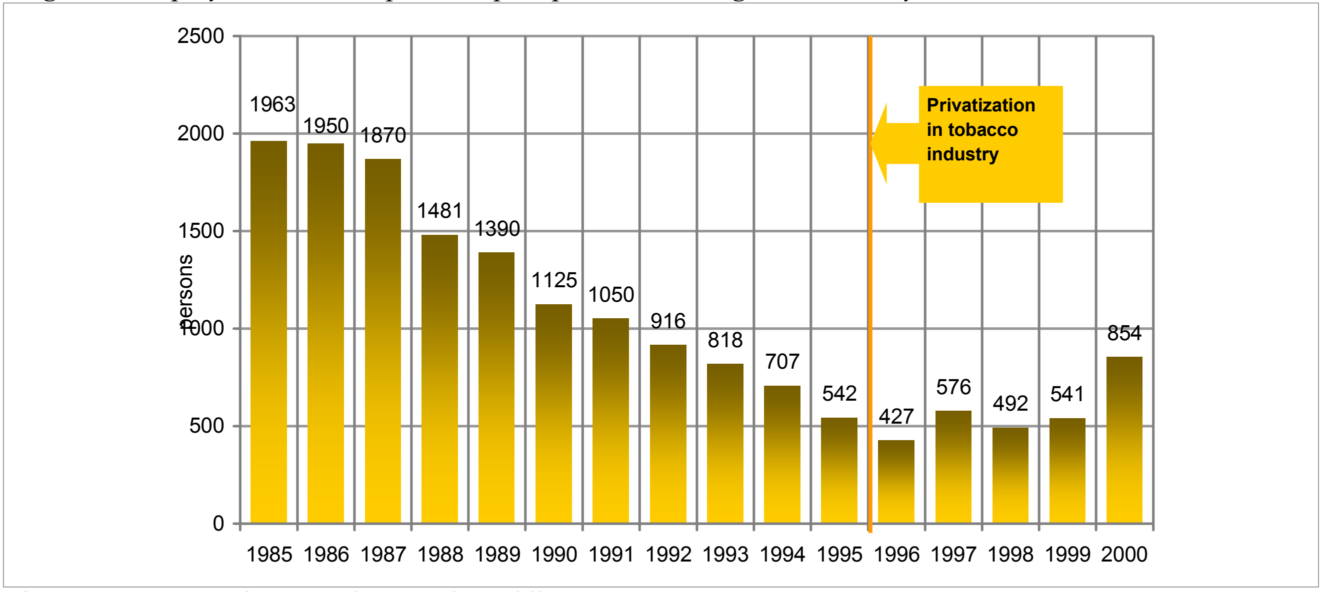
Although the volumes of the imports appeared to be rather high, the local tobacco cultivation volumes are increasing in higher pace and, as seen in the Figure 7, the farmers are not being crowded out from the market. This is obviously conditioned by the fact, that mostly inexpensive brands' production is based on the local tobacco: having occupied the larger share of the local market, these brands' production preserves increasing demand for local tobacco leaves.

3.2. Impact on Public

3.2.1. Employment

After the privatization in December 1995 ArmTabak became non-viable and the process of laying off employees continued until 1999. As opposed to it, the Armenian-Canadian joint venture Grand Tobacco LLC, which was established on the basis of ArmTabak, increased its employment and reached already 760 employees in 2000. In the same year the newly established cigarette manufacturing company SPS Cigaronne LLC, in turn, hired almost 90 employees. The newly established private cigarette companies managed to hire the most qualified employees among those laid off from non-viable ArmTabak. As a consequence, the total labor productivity in two private companies increased substantially from its level of pre-privatization period.

Figure 8. Employment trend in pre- and post-privatization cigarette industry in Armenia[5]



Source: National Statistical Service of RA. Official Letter # 18-3-17, 22/10/2001

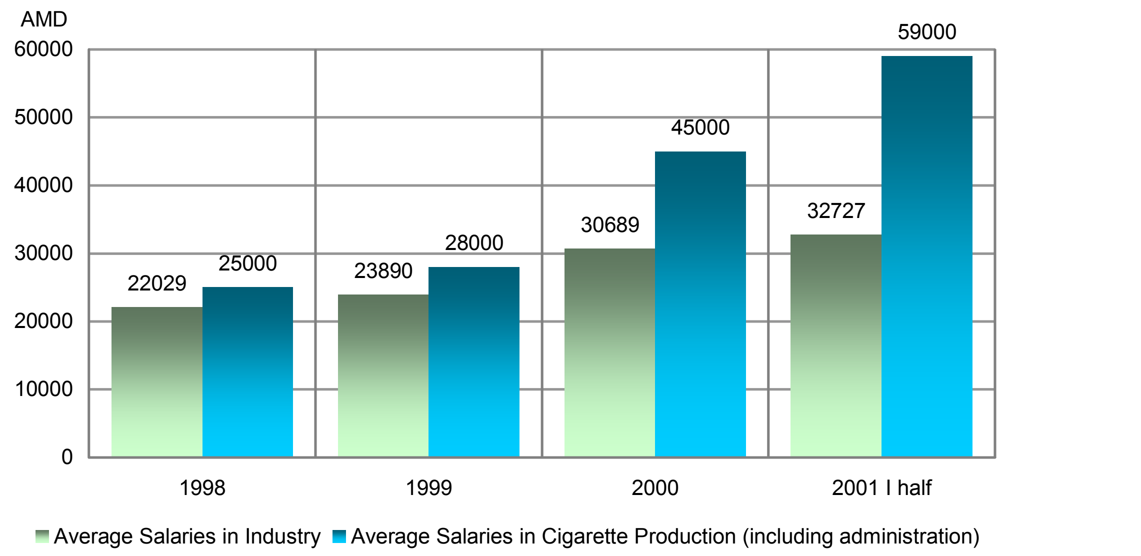
The privatization of tobacco industry resulted also on social conditions of the employees, which, in its turn, had an impact of overall productivity in this sphere.

Observation of all the industries of the Armenian economy comes to prove that private companies usually pay much higher salaries compared to the state sector. The explanation is that, despite the high level of unemployment in Armenia, competition forces the private companies to strive to hire the best employees and pay them better. And particularly, it is best seen in the case of middle and high level management. The present situation in the cigarette industry, which traditionally paid higher salaries to its employees compared to other industries, proves this statement.

Figure 5 shows that the average salary including administration in cigarette industry is higher than that of all industries. In the first half of 2001 the average salary amounted to 59.5 USD (32,727 AMD monthly) in the industrial sector and 107.3 USD (59,000 AMD monthly) in the cigarette industry. Besides, the annual average salary growth in cigarette industry is higher than in other industrial sub-sectors. While the average salary in the industrial sector in 2001 increased by 49% compared to 1998, the average salary increase in the cigarette industry for the same period came to 136%.

5 Data for 1985-1990 are ICHD estimations (the tobacco industry have obtained relatively stable share in overall food industry. Having the date for the latter, we have extrapolated the data on the labor force in tobacco industry, interpolating the available data, using moving averages for smoothing purposes).

Figure 9. Average salaries for the whole industry and the cigarette industry in Armenia



Sources: National Statistical Service of RA, Grand Tobacco LLC, SPS Cigaronne LLC

The situation is totally different with the average salary excluding administration salaries. While this indicator for the whole industrial sector in 1998, 1999, and 2000 amounted to 42.3 USD (22,029 AMD), 45.1 USD (23,890 AMD), and 57.0 USD (30,689 AMD) accordingly, for the cigarette industry it amounted to 37.7 USD (19,656 AMD), 39.3 USD (20,840 AMD), and 42.0 USD (22,659 AMD). As one can see, the wages of non-administrative staff of the cigarette manufacturing enterprises are lower than the whole industrial average. This comes to prove the above-mentioned statement on middle and high-level management employees: that is the private employers compete to hire the most qualified employees. The low rate of wages of non-administrative workers is conditioned with the high level of unemployment in the country especially among less-qualified workforce.

The salary rate in the pre-privatization period is incompatible with the current salary rates. This is conditioned by the huge changes in economy, particularly the hyperinflation, change of the currency etc. Anyway, it could be stated, that in pre-privatization period there was not much difference in the salaries in different industries, which was common for planned economies.

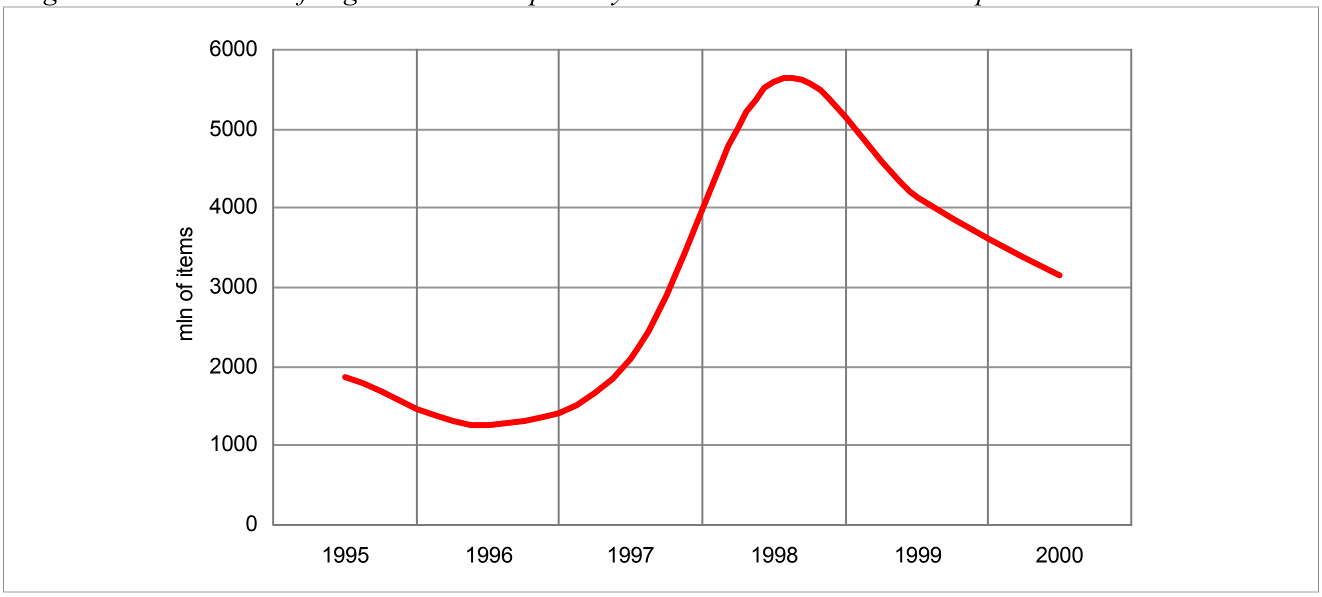
On the other hand, during the pre-privatization period the state enterprises in Armenia as in the other former Soviet Republics provided many non-wage benefits to their employees, such as childcare, housing, kindergartens, food, vacations, leisure facilities, etc., even if it caused losses to them, because that was the overall state policy for the entire government-planned economy. The same situation was in the cigarette industry, and the only cigarette manufacturing company in Armenia, ArmTabak provided almost the entire range of those benefits to its workers. Unlike other post-socialist countries producing tobacco products, where some enterprises still remained public after the privatization process, the cigarette industry in Armenia, as well as the majority of other industries, became entirely private. Private companies, aiming to improve profitability, either totally stopped the practice of non-wage benefits for their employees or reduced them to the minimum. For instance, the so-to-speak successor of ArmTabak state company, Grand Tobacco Ltd. kept some non-wage benefits for its employees, such as leisure facilities, vacations and holiday gifts. It owns a holiday house in a picturesque countryside for its employees to spend their vacations there free of charge. As our interrogation shows the employees are satisfied with the holiday house conditions. Total non-wage benefits provided to employees from Grand Tobacco make up approximately 5 to 7% of the annual salary.

3.2.2. Consumption

The privatization in tobacco industry has also impacted the cigarette consumption structure and prevalence in Armenia. As there is no official data on cigarette consumption in Armenia we tried to make estimations based on available statistical data and show it in two figures:

Figure 10 Estimations are based on statistical data regarding local production (A), quantity of exported (B) and imported tobacco products (C): Local Consumption = (A) – (B) + (C). It was assumed here that there is no change in the annual inventory of cigarette manufacturing enterprises. As it comes from this figure there is increase in tobacco consumption in 2000 vs. 1996 that makes up 148%. A deviation in Figure 8b is possible due to tax legislation toughening in the end of 1999 that caused an expansion of black market. It means that at least the consumption volume has been constant from 1998 to 2000, and the increase in the period of 1996 to 2000 should be considered at 340% in this case. Taking into consideration also the fact that the black market share tended to decrease from 1995 to 1999 the abovementioned rate of consumption increase should be significantly reduced. Thus a conclusion can be made from Figure 10 on growing cigarette consumption trend after privatization, but it cannot be evaluated.

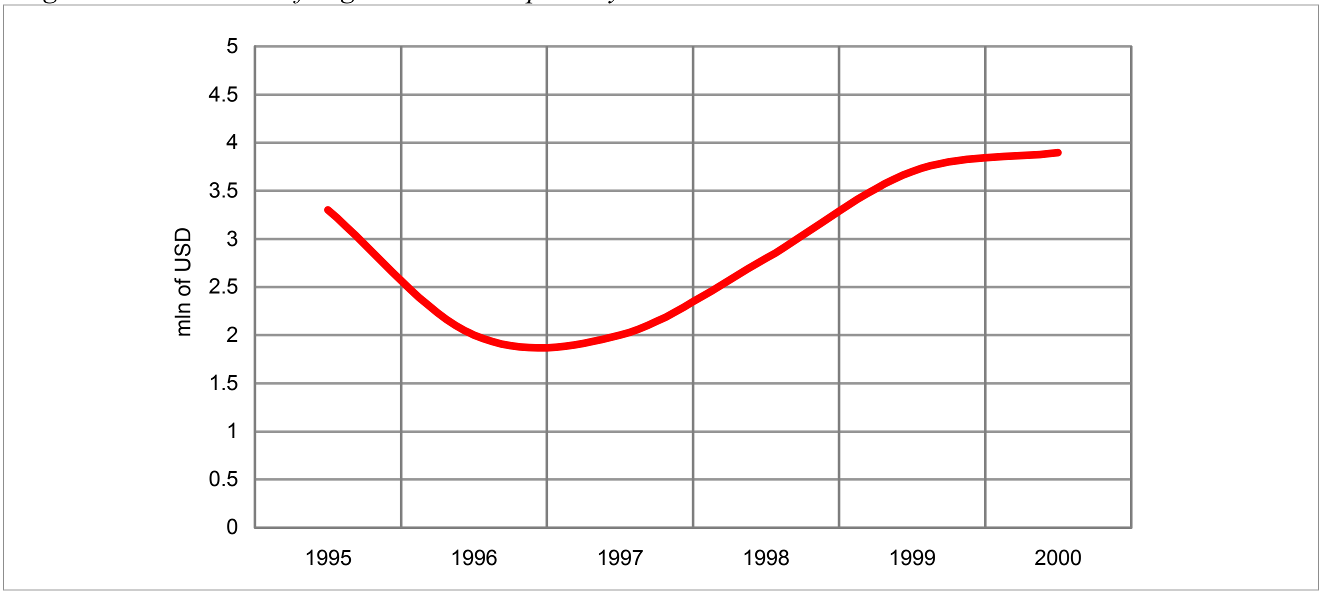
Figure 10: Estimation of Cigarette Consumption by Local Production and Net Export Volumes



Source: ICHD estimations

Figure 11: Estimations are based on retail trade turnover in Armenia and share of tobacco products in it. It was assumed that there is no change in the annual stock of cigarettes remaining in retail trade sector. It shows that the cigarette consumption volume increased almost twice (96%) in 2000 compared to 1996. As a deviation is possible due to the change of purchasing power of US dollar in Armenia (the Purchasing Power Parity (PPP) has changed in Armenia for this period) it can be stated that the real increase makes approximately 40 to 50%. The evaluation of cigarette consumption dynamics in pre and post privatization periods based upon Figure 11 is more realistic.

Figure 11. Estimation of Cigarette Consumption by Retail Trade

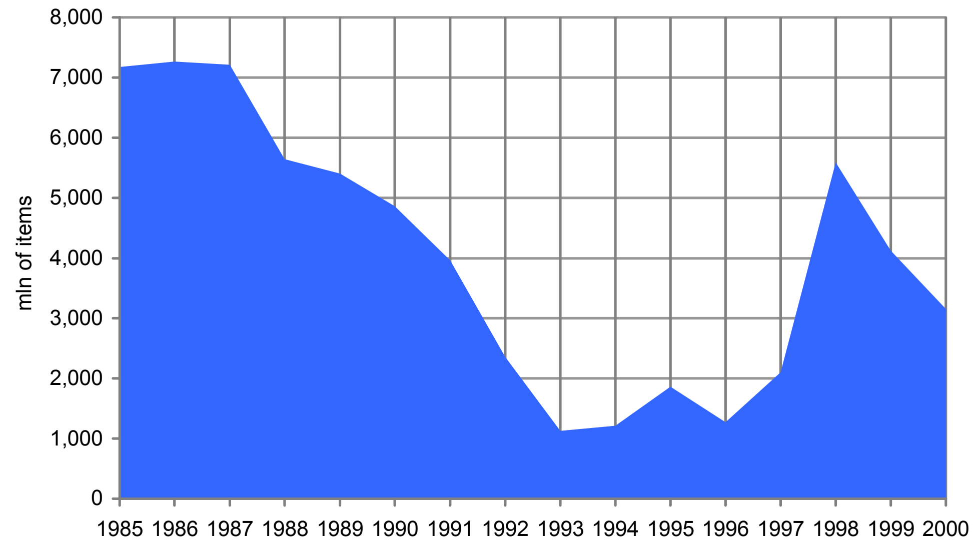


Source: ICHD estimations

So, as shown in Figure 11, the consumption volume of tobacco products showed an increasing trend in post privatization period.

To estimate the consumption of cigarettes during the Soviet period, more approximations and assumptions will be made. Armenia used to be one of the major tobacco products' exporters in the Soviet Union. The official exports data for the mentioned period had always been underestimated, as a serious portion of cigarettes was being exported by individuals, thus not being registered in statistical institutions. As estimated by a former Chief Manager of the state tobacco company, the share of exports constituted nearly as much as 40% of the local production volumes. Imports of foreign cigarettes had never made up a significant share of the local market, so it will not be considered in our estimation. The problem is, that having the production volumes for the 80s and assuming the exports of cigarettes was equal to 40% of the production, we get quantitative data, as in Figure 10. This kind of estimation could hardly be compatible with the estimation done in Figure 11, as the latter represents cigarette consumption based on the total price the consumers paid for cigarettes. The two models do not go well together, as the pricing system and mechanisms of the different economic systems were different and bringing them together would result on major shift from the reality. So the model used in Figure 10 is more convenient for such a comparison. We will, of coarse, keep in mind, that, as mentioned above, the model seems to be less realistic due to the fact, that imports volumes might be underestimated as the share of black market could not be correctly identified.

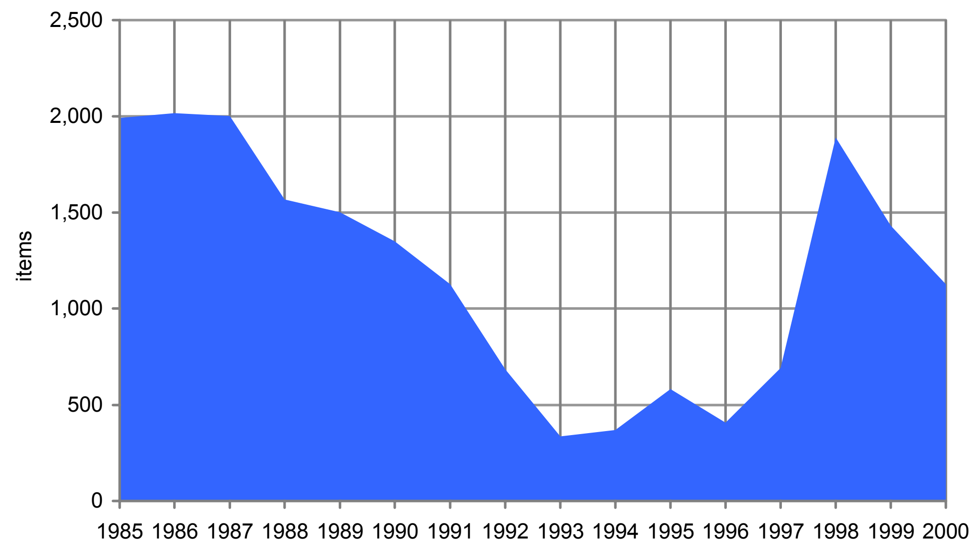
Figure 12. Comparison of consumption levels in 80s, pre- and post-privatization periods.



Source: ICHD estimations

As we see, the estimation shows, that consumption nearly increased as much, as it did in mid- 80s. In the meantime we have to consider, that according to expert's estimations, due to the mass migration from Armenia during early 90s, the population has decreased by about 800000 people during the last 10 years. If we now distribute the mentioned figure by years starting from 1991 and calculate per-capita consumption, based on Figure 12, we will have the following result:

Figure 13. Estimated yearly per-capita consumption.



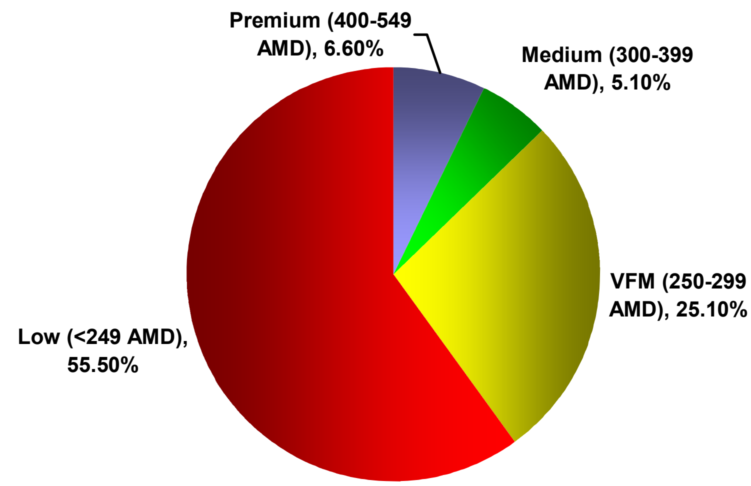
Source: ICHD estimations

If we also adjust the result of the estimation by the previous assumption, that the consumption volumes are underestimated for the post-soviet period, we will come to a conclusion, that the consumption has increased, as compared to Soviet period of Armenian history, as well.

That is due to many factors. The newly established private tobacco enterprises entered the local market with aggressive marketing techniques and sales strategy. The local producers, as well as the imported cigarettes distributors started an active advertising activity. There are no significant restrictions on any kind of tobacco advertising in Armenia and the advertising placement rates are considerably low. The local producers basically produced relatively poor consumer oriented low price brands with better quality than those of the former state-owned ArmTabak. It should be mentioned here that approximately 55% of the population of Armenia is officially considered poor.

The brand range of cigarettes available in the Armenian market is large. Foreign cigarettes of high quality, as well as ones of lower quality and others are sold in the market. Grand Tobacco did not face any problems related to the sale of cigarettes in the local market so far. Its output was sold immediately. In 1997-1999, the sales volume of Grand Tobacco Ltd. cigarettes has gradually grown conquering 75% of the low and middle quality cigarettes in the Armenian market. With the necessary raw materials' base and flexible pricing policy the enterprise continued to expand the production of low and middle quality cigarettes and strengthen its position in the local market still further.

Figure 14. Cigarette Consumption Structure in Yerevan Market by Price (July/August 2001 – price per pack)



Source: ACNielsen Retail Measurement Services

As the survey of Yerevan tobacco products market shows, the market share of cigarettes with prices below 0.45 USD per pack formed 55.5% of the total cigarette market in August 2001. And the market share of cigarettes priced below 0.54 USD per pack made up 80.6%. Almost all brands of cigarettes produced by Grand Tobacco are among this range. The cigarettes produced by SPS Cigaronne relate to super premium cigarettes priced above 1.00 USD (the market share of super premium cigarettes is 7.7% of the total Yerevan cigarette market). The market share of all the domestic brands in Yerevan market of tobacco products in August 2001 made 30.0%.

3.2.3. Impact on Quality:

Privatization resulted on significant changes in overall situation in tobacco industry. The sound economic environment, created after the privatization of the tobacco industry and being the logical consequence of it, created a good basis for competition in this sphere, which, in its turn, brought several positive changes to the quality of the production.

First of all, the implementation of new technologies can be considered as the most positive impact of privatization to the subsequent development of tobacco industry in Armenia. Thus, the greater part of investments in the cigarette industry in the post privatization period was used to acquire new equipment and to update the technology. As an obvious case one can mention Grand Tobacco, which used almost fully depreciated Soviet equipment of the former state-owned ArmTabak in its operation startup period. From the beginning of the new investment strategy implementation the company's fixed assets amounted to 880 thousand USD in 1998, 1,893 thousand USD in 1999, and 2,249 thousand USD in 2000. It has entirely changed the cigarette manufacturing technology to fully comply with European standards. The entire process of cigarette production in Grand Tobacco is carried out with the *Molins, Hauni, Schmermund* and *Decoufle* periodically updated equipment.

As for the other newly-established tobacco company SPS Cigaronne, specialized in manufacturing new age luxury "Cigaronnes", it also uses the most recent equipment provided by internationally famous machinery producing firms. For instance, *Decoufle Sarl*, which manufactures cigarette-making machinery since 1864, recently designed new high-speed filter cigarette-making machines specifically for the unique requirements of Cigaronne. *Focke & Co.* which has made the packaging of tobacco products much more efficient and profitable provided with one of its best machines for packaging of the newly-designed Cigaronne. *Borgwaldt Technik* German high-quality machine manufacturer provided SPS Cigaronne Company with laboratory equipment.

Secondly, as mentioned above, the labor force employed in the tobacco industry became more qualified. The companies started to pay more attention to the training of the personnel and implementation of new methodology of working process.

Along with the tightening of the competition in the market, cigarette importers and producers strengthened their efforts in better introducing local and foreign brands in the market. Together with improving the visual appearance of the product, the companies started to advertise the low contents of tar and nicotine in their products. Local companies started to use the low contents of these ingredients as a serious factor to attract more users. As for the tar and nicotine contents of Grand Tobacco production, the figures are 11.6 and 1.0 mg respectively (the same indicators for the brands with lowest contents of tar and nicotine are 8 and 0.6 mg respectively). The same indicators for Cigaronne company's production are lower, as these cigarettes are equipped with extremely long filters (one filter holder contains as much filtrating material as used in 7 conventional filters), which allows to decrease the contents of tar and nicotine in the cigarette smoke.

Comparison with the similar indicators in pre-privatization and Soviet period shows, that the contents of tar and nicotine decreased radically, as the indicators for an average cigarette during 80s were as follows:

Table 1[6]

N I C O T I N E		T A R	
Quantity of cigarettes	mg per cigarette	Quantity of cigarettes	mg per cigarette
10.00%	17.5	36%	1.25
46%	22.5	61%	1.75
41%	27.5	3%	2.25

[6] L.M.Bernshtain; Endocrinology of Smoking; Saint – Petersburg, NAUKA

3%	32.5		
Weighted average	**24.35**	**Weighted average**	**1.59**

Tough competition gave no chance fore the low-quality production to stay in the market and provided better choice for the consumers to use more qualified and still relatively cheap cigarettes.

3.3. Impact on State

The tobacco industry, once being developed and export-oriented have never been considered as a key industry for the economy. Nor the employment in the industry has been substantial enough to have a decisive role on overall employment or social conditions of the public. This was the reason why the tobacco industry could not have a serious impact on state in pre-privatization period.

The changes in economy and implementation of a principle of market relations forced the Government to revise its taxation policy towards the industry. The high prevalence of smoking and high demand for cigarettes in Armenian market made the sector subject for accented attention of state tax legislation. Tax revenues from tobacco trade reached about 9% of overall tax revenues in 2000 from 4% in 1998 – large portion enough to be considered as a significant source of budget revenues.

What refers to the income taxes paid by the employees involved in the sector, as the recent researches indicate[7], the total number of employees in the cigarette manufacturing sector is small enough to make up serious portion in state revenues, and therefore this aspect could be omitted in the current research.

As for the taxation of investments made in tobacco sector and the profits taxed, it should be noted, that due to the supporting investment climate, established by the Government, the companies that are making investments in Armenia and the companies with foreign capital participation[8] enjoy advantageous tax regime. Firstly, all investments made in Armenia do not undergo any import duties or taxes[9]. Secondly, starting from the year 1998[10], all companies, where more than 1 mln US dollars is invested by non-residents, are enjoying tax holidays according to the following scheme:

Table 2[11]

Year of foreign investment	Profit tax deduction	
	100% in the years	50% in the years
1999	**2000 & 2001**	**2002 – 2009**
2000	**2001 & 2002**	**2003 – 2008**

7 Evaluating the Impact of Tobacco Control Policies on Employment, prepared by ICHD for WHO

8 Minimum of 30% share with foreign capital participation. The “RA Law on Foreign Investments”

9 The “RA Customs Regulation”

10 The “RA Law on Profit Tax”, adopted in 1997.

11 Previous profit tax legislation also provided similar tax holydays: 100% tax exemption for the fisrt year of foreign investment and 50% tax deduction for following 8 years. The eligible volume of investments had been set equal to 100000 US dolars, which had to be more than 50% of the total capital of the company.

2001	**2002 & 2003**	**2004 – 2007**
2002	**2003 & 2004**	**2005 – 2006**
2003	**2004 & 2005**	
2004	**2005 & 2006**	
2005	**2006 & 2007**	
2006	**2007 & 2008**	
2007	**2008 & 2009**	

Consequently, the investments on both cigarette producer companies had not been considered as sources of State budget revenues.

Investments in the major tobacco producer – Grand Tobacco had been made in 1997. Net profit of the company is represented by the table below.

Table 3

	1998	1999	2000	2001
mln of USD	4.10	5.24	8.37	12.43
mln of AMD	2070.9	2746.2	4515.5	6960.1

According to the Law on Profit Tax, the profit tax is currently 20%. It was fluctuating above 15% (depending from the profit volume) before the recent amendments in the Law in 2001.

Grand Tobacco was enjoying profit tax holyday up to year 1999 and had to pay about 8% (50% profit tax deduction) in 2001. The annual amount of profit taxes paid varied from about 669,000 US dollars in 2000 to about 1 million US dollars in 2001.

The Cigaronne SPS company's profit taxes were less, as the production volumes and the market share were less than Grand Tobacco's.

3.3.1. Tobacco Taxation

One of the peculiarities of tobacco production regulating policy in Armenia, which is not common for the countries with the transitional economy, is the high rate of market liberalization. The government does not interfere in tobacco affairs and its role is limited to regulating the taxation rules for tobacco products. Also, during recent years the Government implemented strong measures to reduce the cigarette smuggling: the customs and tax authorities have been strengthened and granted more power – they merged into one institution, which became a ministry (this was done to increase the efficiency of co-operation of these two departments); VAT was started to be collected at the border, which made some inconvenience for importers, but, meanwhile, increased the efficiency of tax collection; the government implemented excise stamps with adequate level of security, which was a strong action against smuggling. The mentioned actions granted an opportunity for private business to compete in the market in fair environment.

No stimulating or restricting policy is being currently implemented by the government in terms of tobacco control principles. The taxation structure in the tobacco production and trade sector is stricter than in other sectors. Extra excise tax and fixed payments are applied to the tobacco products' trade and imports. Yet, considering that the local tobacco production is carried out by only two companies, and the major producer enjoys relieved tax burden as a joint venture, it becomes obvious, that the economic policy of the state is not now seriously limiting the production of cigarettes, nor it is encouraging the latter.

As a consequence of fluctuations in budget revenues, the tax legislation is frequently changing. In April, 2000 a separate Law on "Fixed Payments for Tobacco Products" was adopted by the Parliament[12].

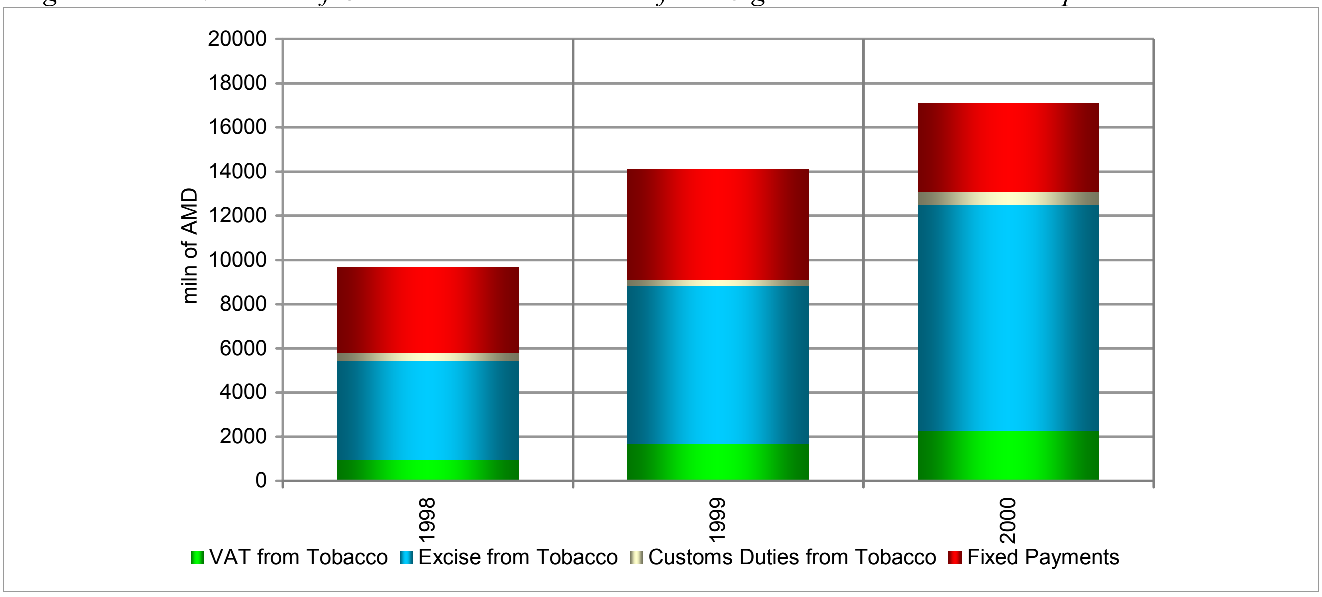
The Law simplified the procedure of tax collection by unifying VAT, excise tax and customs payments in one fixed payment. The size of the fixed payment is different for local and foreign brands, thus granting several advantages to the local producers.

Table 4. The rates of fixed payments, as amended in the Law in December, 2001[13]

Product Type	Units	Local	Imported
Cigars	USD per 1000 items	2200	3000
Cigarillos	USD per 1000 items	22	30
Cigarettes with filter	USD per 1000 items	8	11
Cigarettes without filter	USD per 1000 items	3.5	6

The main purpose of setting higher taxes on tobacco products is to support budget revenues. The excise from cigarette composed about 40 per cent of total revenues from excise tax in 2000. As for the VAT, the share of VAT from tobacco constituted only 3% of total VAT revenues in 2000[14].

Figure 15. The Volumes of Government Tax Revenues from Cigarette Production and Imports



[12] Prior to adoption of the said Law cigarette production was treated equally with other products in terms of taxation rates and procedures.

[13] In the original version of the Law the rates for cigarettes with filters and without filters were 8 USD / 10 USD (local, imported) and 3.5 USD/6 USD respectively.

[14] Although the VAT, excise and customs taxes are unified in a single fixed payment, the share of each is fixed to be able to calculate the revenue of the budget by each type of tax.

Sources: Statistical Yearbook of Armenia - 1997,1998. National Statistical Service of RA. Yerevan 2001

Taxes constitute a serious portion of the cigarette price. The weighted average price of an average cigarette pack is about 380 AMD, which is about 0.6 US dollars. An overall tax payment per an average pack of cigarettes is in average equal to 25 per cent. The same calculation for the most favorite brand – “Red and White” (Phillip Morris) indicates that in this case the share of taxes in the price is nearly 52%, while the cigarette market price is about 42 cents. The local “favorite”, which costs about 20 cents, includes in its price 7 cents (or 35%) of tax payments.

As the payments are fixed, taxation of cigarettes appears to be regressive: the share of taxes in more expensive brands is smaller. The reason of establishing regressive taxation mechanism is obviously conditioned by the fact that cheaper cigarettes have larger market share (Figure 14).

As the conclusion, we can state, that the Government has a serious role in determining prices for cigarettes, which, however, is rather conditioned by the need to collect appropriate budget revenues, rather than by the tobacco control principles.

The local producers enjoy more favorable tax treatment than the importers.

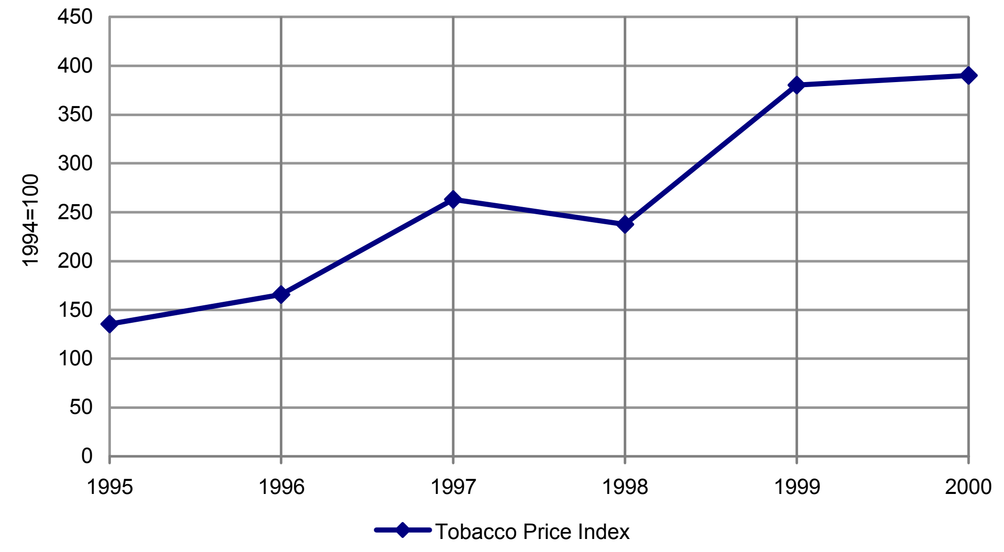
A sound policy advice is needed to adjust the tax policy so that the public interests, such as smoking reduction or the need for public health care, also be considered by the policy makers.

3.3.1.a) Price

Prior to privatization cigarette prices in Armenia were more affordable in comparison with the current situation as the real income went down during the transition period due to the hyperinflation and radical decline in employment. Yet they could not be compared as the prices for pre- and post-privatization period are incompatible, as mentioned above. The financing of the cigarette production had not been dependent from the revenues it had been earning for the State budget. The decision on pricing was made by a separate institution which was in charge of pricing of all retail products. The main principle of decision making was the need to maintain affordable prices for all the products.

Since then, as Figure 16 shows, the prices underwent a durable upsurge till 1997, when Grand Tobacco started its operation. The low and middle class brands manufactured by Grand Tobacco entered the market and caused the price index to go down in 1998. In August 1999 the prices increased much due to the Government decision as of July 30, 1999 on “Definition of Fixed Payments for Tobacco Products Imported and Produced in Armenia” that extended the tax burden for both the importers and domestic producers of tobacco products. The largest increase compared to the previous month was registered in September 1999 – 19.5%. The increase in December 1999 compared to the same period in 1998 was 59.6%. It is important to note also that the tax legislation concerning cigarette industry in Armenia has undergone changes several times after the privatization. Besides, inflation in Armenia also had a great impact on prices of tobacco products.

Figure 16. Price Dynamics of Tobacco Products in Armenia



Source: National Statistical Service of RA

The privatization of the tobacco industry and, meanwhile, liberalization of the government's policy in this sector, which opened the market for well-known tobacco brands, caused tight competition in the local market. In parallel with the need to improve the quality of the products, it initiated a slower increase in real prices in comparison with other products. As the major share (more than half) of the cigarette market is occupied by the cheaper (less than 0.5 US dollars) cigarettes, the companies concentrated their efforts on using all the possibilities to maintain stable prices for their production. For the major producing company – Grand Tobacco - this was achieved by innovation of the technology, which reduced the production costs. Thus, Grand Tobacco gained an advantage to maintain relatively low prices for its production in long term basis.

In spite of the fact, that there is a lack of statistical data on cigarette prices dynamics, in general, one could conclude, that privatization of the cigarette industry in Armenia had a sensible impact on cigarette pricing, as it resulted on following improvements:

- Privatization changed the whole mechanism of pricing. Although it caused an increase in cigarette prices even in real terms, it made possible to implement an economically valid pricing mechanism, which gave a chance for the producers to improve the production and to accumulate necessary funds for further development.
- The openness of the market[15] gave a chance for healthy competition in the market: as mentioned above, two major producers entered the market and started to share it with 5 major cigarette importers. Increasin number of competitors in the market caused tough price competition. Becoming one of the most competitive markets in the country, the cigarette market maintained lower growth rate of prices as compared to other products, even being highly taxed by the state.

[15] Armenian economy is considered to be the most liberal among the CIS countries. According to "2001 Index of Economic Freedom" by the Heritage Foundation, Armenia is included in the category of countries with MOSTLY FREE economy. Its trade policy, according to the said research, has "very low level of protectionism".

3.3.1.b) Non-price tobacco control measures and marketing

The Tobacco Control policy in Armenia is not yet properly shaped as it was considered mainly in one-sided manner. Current policy bears the legacy of the Soviet anti-smoking policy, which can hardly be described as an efficient policy. In the meantime, tobacco control policy is considered mainly under the light of its health impact – the economic aspect of smoking was rarely taken into account.

In modern Armenia anti- smoking campaign is also being considered in a similar manner. The economy, overcoming exogenous and endogenous obstacles, sets more utilitarian goals which do not consider public healthcare principles as top priority. Given these circumstances the global anti-smoking campaign can hardly overwhelm in policy-making process if opposed to economic gains of tobacco production development.

Nevertheless several anti-smoking campaigns, mostly using propagandistic tools and advertising, are from time to time being implemented in Armenia, mostly in Yerevan. Also some permanent measures are carried out by many state institutions, such as cigarette banning or limitations, but are hardly being perceived as a serious restriction.

The legislative basis also sets several restrictions on smoking. The tobacco products' advertising is partly restricted. The Law on Advertising sets several prohibitions to restrict children and youth access to tobacco advertising, such as tobacco advertising by TV, radio and printed media for youth; advertisement of tobacco products to have curing, stimulating or relaxing features; tobacco advertising without a warning statement about the harm of smoking is forbidden; demonstrating the process of use of tobacco during its advertising; advertising through electronic mass media during the hours from 7.00 a.m. to 9 p.m.

A draft Law is now being prepared to strengthen the control over tobacco use. It has several strict prohibitions over tobacco advertisement and its use in public buildings and places. For example, it sets a complete banning on tobacco advertising on radio or TV.

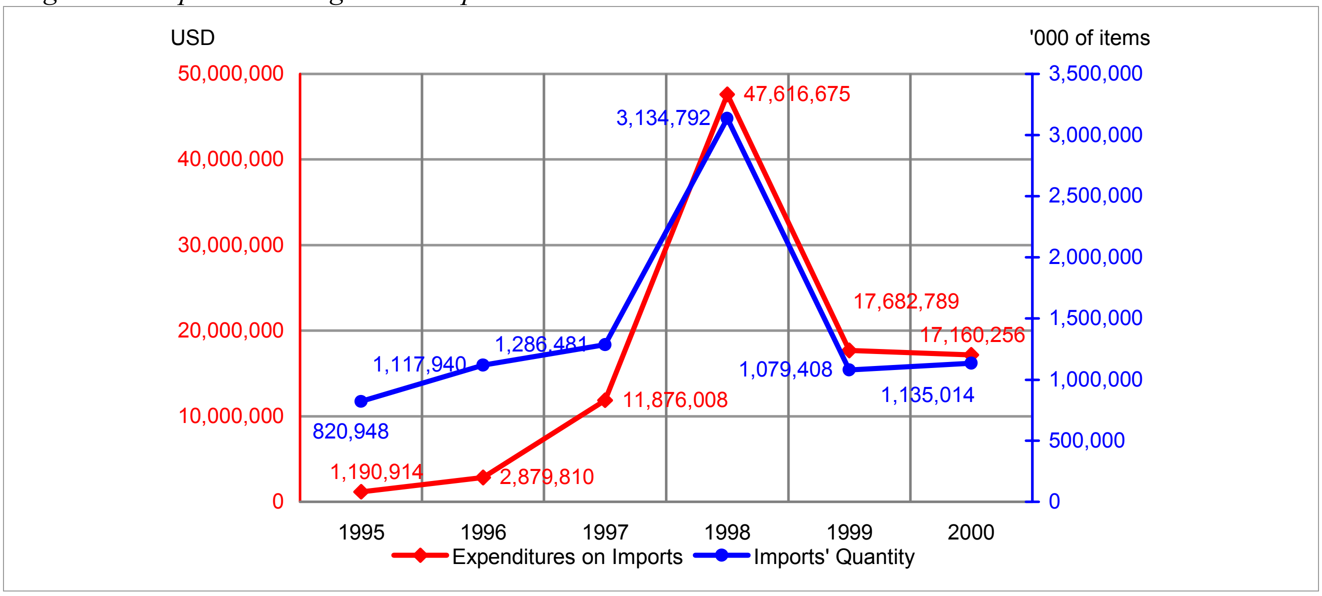
An interesting practice of anti-smoking campaign is currently being implemented by the major cigarette producer in Armenia. Instead of advertising its production the mentioned company does its best to propaganda non-smoking style of life. As a matter of fact, the advertising campaign really includes statistical data on tobacco-related mortality and in fact is expected to affect the smoking population. The phenomenon can only be explained by internal marketing policy of the company, aimed to crowd out the imported cigarettes by affecting the more educated groups of population, which are normally smoking more expensive cigarettes mostly produced abroad. Anyway, the mentioned campaign appears to be the most efficient in Armenia.

3.3.2. Tobacco trade

Armenia started tobacco products' export in mid 1920s. Since then Armenia became one of the main tobacco exporters in Soviet Union. It increased its export volumes until late 80s, when the transition process in economy started. In early 90s the exports almost stopped. It was conditioned both by the crisis in tobacco production and the loss of markets and trade links. Imports also slowed down, although not reaching zero level. The reason was the lack of both financial means and mechanisms for organized imports.

Along with the strengthening of national tobacco industry, the net export of tobacco products raised, although remaining a negative figure. The market share of imported tobacco products started to reduce as the locally produced cigarettes started to substitute the foreign brands. This competition particularly refers to the low price production market share, as the quality/price correlation is more advantageous for local brands. This trend can be clearly observed in Figure 17, where the quantity/price relation declines starting from the year of 1998. This indicates, that the average imported cigarette became more expensive, which means that the importers switched to more expensive brands, or reduced the imports of low-cost cigarettes.

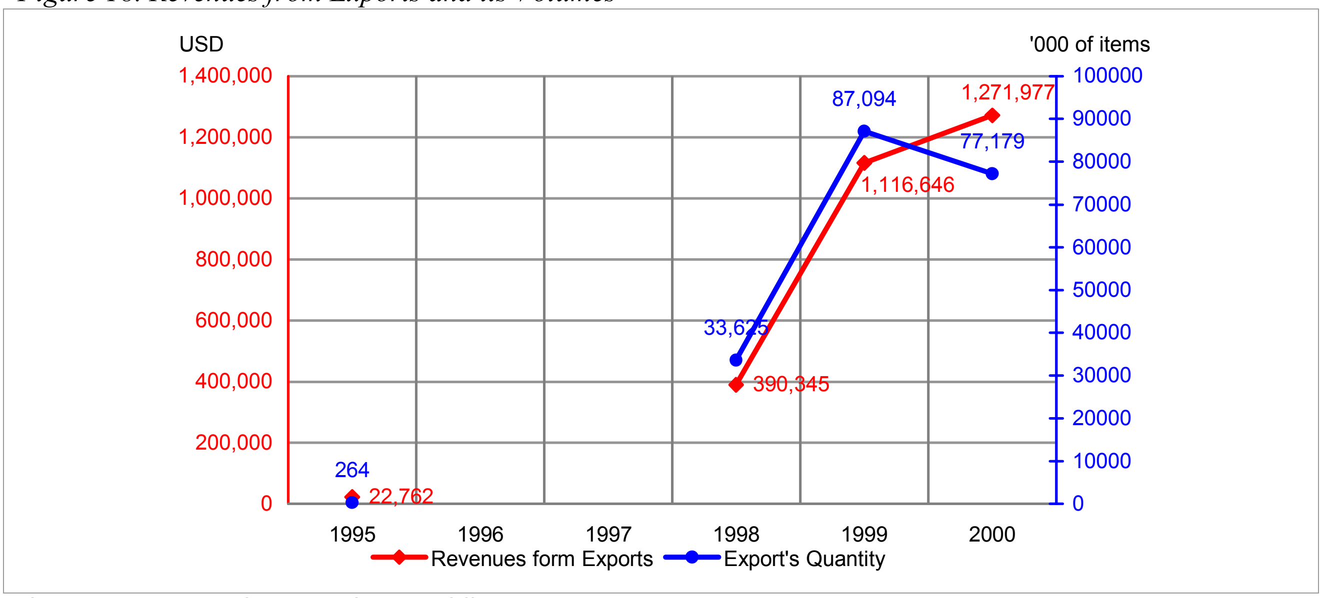
Figure 17. Expenses on Cigarettes Imports and its Volumes.



Source: National Statistical Service. Official Letter # 18-3-17, 22/10/2001

As for tobacco product's exports, it started to rise, as the appropriate level of quality could be achieved by the producers to compete also in the foreign markets.

Figure 18. Revenues from Exports and its Volumes



Source: National Statistical Service. Official Letter # 18-3-17, 22/10/2001

As observable in Figure 18, during the year 2000 local producers started to export more expensive brands of cigarettes. This is conditioned by the exports policy of "Cigaronne" which is directed towards the market of luxury brands.

Along with strengthening of the tobacco industry, it is likely to expect higher exports growth rates as compared to imports growth rates. The exports potential is not realized yet, while the imports is limited by the smoking prevalence of the population.

4. Conclusions

The privatization in tobacco industry had a serious impact on the overall situation in industry and created a completely new environment for producers and for the State.

The main achievement of the privatization process is the creation of the group of private owners, who are able to take the risks and responsibilities for production and development. The privatization in the cigarette industry and establishment of new private enterprises resulted in considerable investment flow to this industry. The comparison of economic indicators for the pre- and post-privatization periods shows that the privatization had the following effects on different interest groups:

The State

- The tax revenues from tobacco production and trade increased (see Figure 15), as the tax legislation became tighter, at the same time becoming more effective.
- Together with elimination of state property in tobacco industry, the government stopped to finance it, thus saving resources for other programs.

The Producers

- The efficiency of production substantially increased due to several factors:
    1. Labor productivity increase: Some key factors played a major role here, such as implementation of new methods of personnel management, training of employees, labor adjustments, implementation of new flexible systems of remuneration and so on.
    2. Implementation of new technologies: Private domestic cigarette manufacturers have installed new equipment fully complying with European standards and provided by internationally famous cigarette making machinery producers.
- Tobacco farmers started to enjoy the advantage of prepayments for their production. As the result, the quantity of farmers involved in tobacco cultivating increased a lot, which, in its turn, resulted in increase of tobacco harvest volumes.

The Public

- New high quality brands of cigarettes with good-looking design entered the market to make smoking available to the relatively poor majority of the population of Armenia.
- The price of the cigarettes increased in real terms, yet maintaining slower growth rate in comparison with other products.
- The operation of local producers and the presence of well-known imported cigarettes distributors created a tight competition in this industry. Both of them used aggressive marketing and sales strategies and actively advertised their production. In turn, it enlarged the cigarette consumption level.

- The employment in tobacco industry started to grow since the crisis in economy. The working conditions and the salaries started to grow, as well.

Implementation of new technologies and labor productivity improvement by local cigarette producers created more capacity than they are using to produce presently. It means that a significant growth of domestic production of tobacco products in Armenia is still expected. At the meanwhile an anti-smoking campaign was not implemented in the past and it is not implemented nowadays. Therefore, detailed elaboration and subsequent implementation of such a complex project presently becomes a must.