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Report Highlights:

The Russian tobacco industry boomed in 1999 as consumer preference shifted from imported cigarettes to domestically produced cigarettes made with imported raw tobacco. In 1999, there were some early indications of overproduction as reflected in increasing competition between cigarette brands. Although Post forecasts from 2000 further increases in tobacco imports and domestic tobacco production, increasing competition may lead to consolidation in the industry as smaller, less competitive firms are forced out of business or bought out.

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Executive Summary	1
Production	1
Unmanufactured tobacco	1
Cigarettes	2
Consumption	3
Unmanufactured Tobacco	3
Cigarettes	3
Trade	4
Unmanufactured Tobacco	4
Cigarettes	4
Stocks	5
Policy	5
Excise Taxes	6
Marketing	7
PSD and Trade Tables	8
Price Tables	15

Executive Summary

The Russian tobacco industry boomed in 1999 as consumer preference shifted from imported cigarettes to domestically produced cigarettes made with imported raw tobacco. In 1999, there were some early indications of overproduction as reflected in increasing competition between cigarette brands. Although Post forecasts from 2000 further increases in tobacco imports and domestic tobacco production, increasing competition may lead to consolidation in the industry as smaller, less competitive firms are forced out of business or bought out.

Production

Unmanufactured tobacco

Tobacco production increased in 1999 to 1,530 metric tons, a threefold increase from the previous year. This increase resulted from an 11 percent increase in sown area, made possible by upgraded technology supported by cigarette manufacturers. Production of tobacco is concentrated in Krasnodar Krai, which is also a major center for tobacco manufacturing. Production remained small in other southern regions of Russia where tobacco production was higher before 1990. Domestic production is all Oriental type tobacco, which also composes most of the imports. This flavor is traditionally preferred by Russian smokers over other types. Because domestic production covers less than 1 percent of consumption, the Russian tobacco industry depends on imported raw materials.

Table 1. Unmanufactured Tobacco production, by Type

Production Table						
	Area Planted			Production		
	(HECTARES)			Metric Tons		
	1998	1999	2000	1998	1999	2000
Burley	0	0	0	0	0	0
Dark Air Sun	0	0	0	0	0	0
Dark Air Cured	0	0	0	0	0	0
Dark Fire Cured	0	0	0	0	0	0
Flue Cured	0	0	0	0	0	0
Light Air Cured	0	0	0	0	0	0
Oriental	990	1100	1200	520	1530	1700
	990	1100	1200	520	1530	1700

Cigarettes

Production of cigarettes and papirosas increased to a historic high of 263 billion pieces, up from 180 billion pieces in 1998. Significantly, 1999 was the first year in which the supply of cigarettes in the Russian market exceeded demand. Based on current indications post expects production to increase in 2000, worsening the problem of overproduction and increasing stocks. This and the high cost of imported cigarettes will push imports down.

Most Russian cigarette production is concentrated at 20 factories which are members of the association Tabakprom and are mostly either foreign companies or joint ventures. These large factories were created with investments from overseas, a trend that is increasing with total investments in the tobacco industry reaching \$635 million in 1998 - 1999. As a result, production at foreign companies and joint ventures has increased to more than half of total production. Production at RJR-Petro increased to 55 billion pieces in 1999, while Philip Morris and Ligett Ducat doubled production to 110 billion pieces. Shares of the main foreign companies and joint ventures were: JT/RJR - 18.8%, Philip Morris - 15.8%, BAT/RPM - 9.9%, Ligett Ducat - 5.1%, Bulgar Tabak - 1.3%.

At the same time, production at non-foreign factories has also been rising. This increase is fueled by local administrations interested in job creation, and the half of any collected excise taxes that go to local budgets. The result has been to make investment in small factories attractive. For example, setting up a small factory to produce 2 billion filterless papirosas a year costs about \$800,000 -- and expenses can be covered in two years. Investment in the modernization of Russia's tobacco industry became attractive because in most cases the regions are interested in quick returns on invested money, on stable cigarettes supplies, and in additional budget revenues. To accommodate tobacco companies, regions usually provide investors with the favorable terms of credits and low payments for land.

For example, tobacco producer Dontabak (Rostov-on-Don) intends to finish building a new tobacco production plant

outside the city worth \$30 million as part of an overall project to remove the enterprise's main production facilities from the center of Rostov-on-Don to the outskirts of the city. The new tobacco facility will be able to process 35,000 tons of tobacco annually. In 1999 Dontabak produced 31 billion units against 21.6 billion in 1998. The enterprise paid 1.5 billion rubles worth of taxes, customs duties and other payments to all levels of government. Tax payments made to the region's consolidated budget rose from 210 million rubles in 1998 to 615 million rubles in 1999. To help them, the Rostov administration and Rostov-on-Don have given the enterprise a 50% land and property tax break into 2000.

At the same time, many small local tobacco factories continue to sprout up in the regions, often with the cooperation of regional authorities. These factories produce cheap and low quality cigarettes often in violation of health safety requirements. According to industry sources, there are more than 100 of these factories where products quality is difficult to control.

Consumption

Unmanufactured Tobacco

Domestic consumption of tobacco increased from 180,460 tons in 1998 to 265,700 tons in 1999. Post forecasts a further (but slowing) increase in consumption of tobacco in 2000 to 276,600 tons. This forecast is based on the big monthly imports of tobacco in the beginning of 2000 and estimates of industry sources.

Cigarettes

According to official estimates, demand for cigarettes is estimated at 240-270 billion pieces per year. Despite the dramatic increase in cigarette production in 1999 to 263 billion pieces, there is no a glut of cigarettes on the market. Industry specialists estimated, however, that by the end of 1999 the supply of cigarettes was at least 10 billion pieces more than the demand. Post forecasts a further inertial increase in production of cigarettes to 273 billion pieces in 2000 which should lead to a shakeout of the less competitive firms through bankruptcies and buyouts. However, some local governments may be unwilling to let their local factories fail, making it likely that there will be local "cigarette wars" involving the closure of regional borders through different administrative and non-administrative measures to prevent cigarettes produced elsewhere from entering the regions.

At present 31 percent of the cigarette market is supplied with cheap Prima cigarettes (with or without filter). The cheap non-filter papirosa brand "Belomorkanal" has 7 percent of the market while the high quality filter cigarettes (Pall Mall, Chesterfield, Marlboro) have not more than 4 percent.

Trade

Unmanufactured Tobacco

Exports and re-exports of tobacco fell to less than 500 tons while imports of tobacco increased by 35 percent from 196,440 tons in 1998 to 265,000 tons in 1999. Kyrgyzstan and India remain the biggest suppliers, followed by Moldova, China, Uzbekistan, Greece, Azerbaijan, Italy, Indonesia and Turkey. At least half of the Indian tobacco is supplied through an inter-Governmental agreement as repayment of former debts. At the same time, exporters have diversified -- the share of the 10 largest suppliers of unmanufactured tobacco decreased from 75 percent to 67 percent. Imports from the U.S., the 11th largest supplier, increased from 4,460 tons in 1998 to 9,670 tons in 1999 and mostly went to U.S. and other joint venture tobacco manufacturing plants. The value of imported tobacco decreased because of lower prices and a shift to less expensive tobacco. Post forecasts a further increase in tobacco imports to 275,000 tons in 2000.

Cigarettes

The trade in cigarettes fell significantly in 1999 because of domestic over production dropping from 65 billion to an estimated 22 billion pieces. Official exports of tobacco also decreased. Post estimates are based on official State Custom' statistical data. However, sources report that smuggling of cigarettes still flourishes in Russia, especially to Ukraine. In 1999, smuggling from Russia to Ukraine increased because the Ukrainian government introduced a high tax on tobacco products in 1999. This created a price difference that drew cheap Russian cigarettes from the southern regions through the semi-transparent borders to Ukraine.

Tariffs

High dependence on imported tobacco has kept import barriers low because of strong lobbying by manufacturers in favor of easier imports. The interests of Russian tobacco producers are also reflected in the gap between the tariffs on imported unmanufactured tobacco and on imported tobacco products. Official trade data show that the share of imported cigarettes in domestic consumption fell from 26 percent in 1998 to 8 percent in 1999. The 1998 financial crisis and ruble devaluation explain much of this shift.

Import tariffs for unmanufactured and manufactured tobacco products remain unchanged from 1999 and are given below:

HS CODE	COMMODITY	IMPORT TARIFF
2401	Unmanufactured tobacco, tobacco refuse	5 percent
2402	Cigars, cigarillos and cigarettes, of tobacco or of tobacco substitutes	30percent, but not less than 3 Euro per 1,000 pieces
2403	Other manufactured tobacco and tobacco substitutes; homogenized or reconstituted tobacco; tobacco extracts and essences:	
2403 10	Smoking tobaccos, whether or not containing tobacco substitutes in any proportion	20 percent
2403 91	Homogenized or reconstituted tobacco	20 percent
2403 99	Other, including chewing and snuff tobacco	30 percent

Stocks

Stocks of raw tobacco increased to 30,000 tons, and Post forecasts that the stocks will be kept at least the same level, since they are controlled by manufacturers with an interest in smooth operations.

Stocks of cigarettes are not registered by the Post's PSDs, although keeping significant stocks of cigarettes at warehouses is normal in Russia -- and these stocks are likely to grow. Industry sources indicate that these stocks will impede restructuring of manufacturing and distribution of tobacco products in 2000.

Policy

Although tobacco plays a significant role in some regional economies and is favored by local governments and Russia's tariff structure, it is also highly regulated. Russia has recently passed several resolutions increasing control over the tobacco industry.

Resolution #648 of June 18, 1999 required that all tobacco and tobacco products manufactured in the Russian Federation (except for exports) to have marks of identity starting August 1, 1999

Resolution #1008 of September 4, 1999 mandated that each piece of all imported tobacco and tobacco products shall be marked by specially designed excise stamps. The price of 100 stamps is 7.5 R (\$0.3).

The Russian government has also tasked authorities with licensing all operations related to the production and wholesale trade of tobacco products. According to a Cabinet resolution, signed by President-elect Vladimir Putin, the Tax Ministry will be responsible for handing out the licenses, which will last no less than three years. The Russian government has set the fee for reviewing potential license applicants at three times the minimum wage, which is at present \$3. The fee for granting a license is set at 10 times the minimum wage or \$30. The fees are low, but licensing procedures are expected to increase the role of government officials in the industry's decision making process.

Excise Taxes

Excise taxes for all but the least expensive cigarettes continue to increase. In most cases, these taxes have more than doubled since 1998.

New and Old Excise Taxes for Tobacco Products, 1998-2000

Commodity	Excises (1998), rubles	Excises (1999), rubles	Excises (2000), rubles
Pipe tobacco (Russian GOST standard)	n.a.	16 R per 1 kg	32 R per 1 kg
Smoking tobacco, except tobacco which is used as raw material for manufactured tobacco products	60 R per 1 kg	72.0 R per 1 kg	144 R per 1 kg
Pipe tobacco (except pipe tobacco Russian GOST standard)	140.0 R per 1 kg	168.0 R per 1 kg	336 R per 1 kg
Cigars (except Russian GOST standard cigars)	3.0 R per piece	3.60 R per piece	7.2 R per 1 kg
Cigars (Russian GOST standard)	1.0 R per piece	1.20 R per piece	2.4 R per 1 kg
Cigarillos and filter cigarettes over 85 millimeters long	25.0 R per 1,000 pieces	30.0 R per 1,000 pieces	60.0 R per 1,000 pieces
Filter cigarettes (except cigarettes over 85 mm long and GOST grade 1, 2, 3 and 4 cigarettes)	17.0 per 1,000 pieces	20.50 R per 1,000 pieces	41.0 R per 1,000 pieces

Filter cigarettes (GOST grades 1, 2, 3)	n.a.	14.50 R per 1,000 pieces	29 R per 1,000 pieces
Filter cigarettes (GOST grade 4)	n.a.	9.50 R per 1,000 pieces	19 R per 1,000 pieces
Cigarettes without filter	6.0 R per 1,000 pieces	7 R per 1,000 pieces	7 R per 1,000 pieces
Papirosas (grade 1)	4.0 R per 1,000 pieces	4.80 R per 1,000-pieces	4.8 R per 1,000 pieces

Source: *Economica I Zhyzn*, #13, March 1998, *Economica I Zhyzn*, #2, January, 1999

Quality, Safety and Health

No changes were made in official quality, safety and health requirements (see RS8023, sent May 5, 1998). While increased production of filtered cigarettes at the big foreign or joint venture factories has led to improvement of tar and nicotine characteristics of cigarettes, most cheaper tobacco products do not meet safety requirements on tar and nicotine. The Russian anti-smoking movement remains very weak, although advertizing of tobacco products on TV is prohibited. The Health Committee of the Duma, has prepared for the second reading a draft law, "On restricting tobacco smoking and consumption of tobacco products." This law envisages the introduction of minimum retail prices (200 percent production cost) and minimum excises (of 80 percent), and a decrease in the legal level of tar in the cigarette smoke from the present 20 mg to 12 mg and level of nicotine from 1.3 mg to 1.1 mg. This standard is closer to Western standards. If the law adopted by all levels and signed by the President, it will not come into force earlier than March 2003. Although the tobacco lobby representing the interests of modern factories may favor this law, it will be opposed by the local authorities who have their own interests in small outmoded factories that produce cheap cigarettes.

Marketing

According to industry sources, 2000 will be a difficult year for manufacturerers of tobacco products. Increased production of cigarettes, tough competition, lower consumer incomes and outmoded wholesale and retail distribution systems have already stimulated the large factories to decrease prices of their products and streamline their distribution systems. Distribution is expected to shift from independent distributors to the creation of wholesale marketing and distribution chains. With the increased presence of foreign companies in the Russian market brand name and property right issues may also became very important. Currently, brand names are now mostly protected by membership in the Tabakprom association, which includes most manufacturers.

PSD and Trade Tables

PSD, Tobacco, Unmanufactured, Total, Hectares, Metric Tons

PSD Table						
Country:	Russian Federation					
Commodity:	Tobacco, Unmfg.					
		1998		1999		2000
	Old	New	Old	New	Old	New
Market Year Begin		01/1998		01/1999		01/2000
Area Planted	990	990	900	1100	0	1200
Beginning Stocks	9700	9700	30000	30000	0	30000
Farm Sales Weight Prod	520	520	600	1530	0	1700
Dry Weight Production	500	500	560	1450	0	1600
U.S. Leaf Imports	4460	4460	4000	9670	0	12000
Other Foreign Imports	196440	196440	158000	255000	0	263000
TOTAL Imports	200900	200900	162000	264670	0	275000
TOTAL SUPPLY	211100	211100	192560	296120	0	306600
Exports	640	640	0	420	0	0
Dom. Leaf Consumption	500	500	560	1400	0	1500
U.S. Leaf Dom. Consum.	4460	4460	4000	9000	0	10000
Other Foreign Consump.	175500	175500	186000	255300	0	265100
TOTAL Dom. Consumption	180460	180460	190560	265700	0	276600
TOTAL Disappearance	181100	181100	190560	266120	0	276600
Ending Stocks	30000	30000	2000	30000	0	30000
TOTAL DISTRIBUTION	211100	211100	192560	296120	0	306600

Export Matrix: Unmanufactured Tobacco, Metric tons

Export Trade Matrix			
Country:		Units:	
Commodity:			
Time period:			
Exports for	1998		1999
U.S.	0	U.S.	0
Others		Others	
Bulgaria	199	Bulgaria	250
Lithuania	157	Lithuania	100
Ukraine	73	Ukraine	50
Kazakhstan	55		
France	14		
Total for Others	498		400
Others not listed	2		20
Grand Total	500		420

Import Matrix: Unmanufactured Tobacco, Metric Tons

Import Trade Matrix			
Country:		Units:	
Commodity:			
Time period:			
Imports for	1998		1999
U.S.	4460	U.S.	9670
Others		Others	
India	33995	Kyrgyzstan	30040
Kyrgyzstan	24709	India	27568
China	23480	Moldova	20062
Moldova	13567	China	18203
Indonesia	12682	Uzbekistan	17623
Greece	10254	Greece	16490
Turkey	10239	Azerbaijan	16149
Italy	9594	Italy	11741
Canada	7884	Indonesia	11590
Kazakhstan	4588	Turkey	9750
Total for Others	150992		179216
Others not listed	45448		76114
Grand Total	200900		265000

PSD, Tobacco, Unmanufactured, Oriental, Hectares, Metric Tons

Production Table						
Country:						
Commodity:	Oriental					
		1998		1999		2000
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	990	990	900	1100	0	1200
Beginning Stocks	5000	5000	20000	20000	4000	20000
Farm Sales Weight Prod	520	520	600	1530	0	1700
Dry Weight Production	500	500	560	1450	0	1600
U.S. Leaf Imports	0	0	0	0	0	0
Other Foreign Imports	175000	175000	140000	190000	0	195000
TOTAL Imports	175000	175000	140000	190000	0	195000
TOTAL SUPPLY	180500	180500	160560	211450	4000	216600
Exports	640	640	0	420	0	0
Dom. Leaf Consumption	500	500	510	1030	0	1600
U.S. Leaf Dom. Consum.	0	0	0	0	0	0
Other Foreign Consump.	159360	159360	156050	190000	0	195000
TOTAL Dom. Consumption	159860	159860	156560	191030	0	196600
TOTAL Disappearance	160500	160500	156560	191450	0	196600
Ending Stocks	20000	20000	4000	20000	4000	20000
TOTAL DISTRIBUTION	180500	180500	160560	211450	4000	216600

PSD, Tobacco, Manufactured, Cigarettes, 1,000,000 pieces

PSD Table						
Country:	Russian Federation					
Commodity:	Tobacco, Mfg., Cigarettes					
		1998		1999		2000
	Old	New	Old	New	Old	New
Market Year Begin		01/1998		01/1999		01/2000
Filter Production	110000	110000	115000	168000	0	177000
Non-Filter Production	70500	70500	75000	95000	0	96000
TOTAL Production	180500	180500	190000	263000	0	273000
Imports	65000	65000	44500	22450	0	15000
TOTAL SUPPLY	245500	245500	234500	285450	0	288000
Exports	1500	500	2500	450	0	1000
Domestic Consumption	244000	245000	232000	285000	0	287000
TOTAL DISTRIBUTION	245500	245500	234500	285450	0	288000

Export Matrix: Cigarettes, Exports, Million of Pieces

Export Trade Matrix			
Country:		Units:	MLN PCS
Commodity:			
Time period:			
Exports for	1998		1999
U.S.	0	U.S.	0
Others		Others	
Turkmenistan	100	Lithuania	100
Kazakhstan	50	Kazakhstan	70
Kyrgyzstan	40	Kyrgyzstan	50
Belgium	30	Belgium	30
Georgia	30		
Lithuania	20		
Total for Others	270		250
Others not listed	230		200
Grand Total	500		450

Import Matrix: Cigarettes, Imports, Million of Pieces

Import Trade Matrix			
Country:		Units:	MIL PCS
Commodity:			
Time period:			
Imports for	1998		1999
U.S.	27500	U.S.	6000
Others		Others	
Brazil	8000	Ukraine	6200
Germany	7000	Germany	2300
Ukraine	6000	Netherlands	2100
Check Rep.	5000	UK	2000
UK	4000	Check Rep.	800
Switzerland	2500	Switzerland	700
		Finland	500
		Belgium	300
Total for Others	32500		14900
Others not listed	5000		1550
Grand Total	65000		22450

Price Tables

Unmanufactured Tobacco

Domestic tobacco production is only 1 percent of domestic consumption, and prices of unmanufactured tobacco for the tobacco processors tend to be the average wholesale prices of tobacco imports (without VAT). Because tobacco prices fell in international markets, Russian importers tended to buy more cheaper tobacco from the CIS and the developing countries.

Prices Table					
Country:					
Commodity:					
Year:	1999				
Prices in (currency)	US dollars	per (uom)	Metric ton		
Year	1998	1999	% Change		
Jan	1977	1885	-4.7%		
Feb	2009	2005	-0.2%		
Mar	2180	2101	-3.6%		
Apr	1980	2010	1.5%		
May	2434	1772	-27.2%		
Jun	2011	1915	-4.8%		
Jul	2208	1922	-13.0%		
Aug	2198	1878	-14.6%		
Sep	2076	2059	-0.8%		
Oct	2338	2031	-13.1%		
Nov	2212	1846	-16.5%		
Dec	1906	1895	-0.6%		

Price Table for Manufactured Tobacco

Prices given below are the wholesale prices for imported cigarettes. The reasons for use of these prices in absence of official information on average price of domestically consumed cigarettes.

Local Russian sources reported that tobacco companies in summer and the fall 1999 were forced to decrease prices of tobacco products due to severe competition and low income of majority of consumers.

Prices Table					
Country:					
Commodity:					
Year:	1999				
Prices in (currency)	US dollars	per (uom)	1,000 pieces		
Year	1998	1999	% Change		
Jan	9.84	11.98	21.7%		
Feb	9.71	12.39	27.6%		
Mar	13.94	11.09	-20.4%		
Apr	14.16	10.53	-25.6%		
May	13.51	10.85	-19.7%		
Jun	13.16	11.37	-13.6%		
Jul	14.24	10.6	-25.6%		
Aug	12.55	11.04	-12.0%		
Sep	13.47	12.08	-10.3%		
Oct	13.78	10.62	-22.9%		
Nov	11.11	12.4	11.6%		
Dec	12.73	11.92	-6.4%		