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Report Highlights:

Although domestic leaf production is estimated to increase by a third in 2003, it remains insignificant compared to consumption needs, leaving Russia heavily dependent on imports. Domestic consumption of cigarettes is declining, resulting in an oversupply on the market. Thus, imports of cigarettes are declining while exports are increasing significantly.

Includes PSD changes: Yes
Includes Trade Matrix: Yes
Annual Report
Moscow [RS1], RS

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Executive Summary

Russia will continue to import a significant amount of unmanufactured tobacco in 2003 as domestic production satisfies less than one percent of demand. According to trade sources, there is currently overproduction of cigarettes in the Russian market, reflecting higher capital investments in the sector as opposed to the overall declining consumer trends in consumption and more expensive licensing procedures. The result is a decline in cigarette production; however, Russian exports of cigarettes are estimated to increase significantly by forty percent because of a greater variety of high-quality cigarettes reaching international standards. Cigarette imports are estimated to decline by twenty percent because of the current overproduction of cigarettes.

According to "GrandTabak" association, there are more than 100 tobacco manufacturing companies in Russia, of which 30 are large companies. However, according to our trade sources, the current trend in the industry calls for higher concentration of production among eight companies, of which five are multinationals and three are Russian owned companies.

Collection of excise duties is becoming a significant source of revenues for the state budget. Government initiatives are directed towards more control over foreign trade of tobacco and tobacco products and fighting illegal marketing. The State Customs Committee Order Number 1205/112, dated December 26, 2002 established the procedures for introducing excise marks on imported tobacco. In addition, a new excise system is in place, the so-called "mixed" rate (a combination of specific tax and ad valorem tax).

Production

Unmanufactured Tobacco

Post forecasts MY 2003 unmanufactured tobacco production at 2,000 metric tons (mt), farm sales weight (FSW), up a third from the revised 2002 crop of 1,500 mt. This significant increase is attributed to expanded planted area and expected improvements in yields compared to last year's crop. Trade sources also reported that good weather conditions during the early season stimulated leaf development.

Domestic production is composed of only oriental tobacco, which is traditionally preferred by Russian smokers, but is still insignificant and represents less than one percent of total tobacco consumption, leaving the Russian industry heavily dependent on imports. Some trade sources think Russia has the potential to increase domestic production by 20, even 30 percent and some leading tobacco companies are investing in major producing regions, such as Krasnodar Krai (where 90 percent of all tobacco is produced) and Dagestan. It is forecast that these two regions together will be producing about 8,500 metric tons of oriental tobacco by 2006 due to these higher industry and government investments.

Table 1. Tobacco: Area and Production, by Type

Production Table						
	Area Planted			Production		
	(HECTARES)			Metric Tons		
	2001	2002	2003	2001	2002	2003
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	2000	2100	2200	1600	1500	2000
Total	2000	2100	2200	1600	1500	2000

Cigarettes

Post forecasts cigarette and papirosas production in 2003 at 380 billion pieces (BP), a slight decline from a year ago due to the current overproduction of tobacco products, and a small decline in consumption because of higher tax policies and consumer health concerns.

Production of filtered cigarettes, however, is estimated to increase slightly reflecting greater investments in quality and marketing by major multinational companies to attract consumers with higher purchasing power and preferences for better-quality cigarettes. On the other hand, nonfiltered cigarettes are forecast to decline by more than six percent. This trend towards production of filtered cigarettes will likely continue in the near future.

According to experts, ("Business Analytica" data, published in Izvestiya on October 31, 2002) multinational companies located in Russia increased their market share to 87 percent of total production in 2002, up slightly from the previous year. Philip Morris led the pack producing 23.8 percent of all manufactured tobacco products and investing an estimated US\$30 million to upgrade its plants. Trade sources indicate that Philip Morris has increased its capacity to produce an additional 50 billion cigarettes per year, lessening the need for imports. Other large tobacco companies and their market share of total production are: JT International (15.3 percent), Gallaher (14.1 percent), BAT (13.8 percent), and Reemsta (4.1 percent). Russian-owned firms include Balkanskaya Zvezda (7.8 percent, with almost two percent decrease from 2001) and Don Tabak (7.7 percent), other local firms accounted for 13.7 percent of all tobacco products.

Consumption

Unmanufactured Tobacco

Post estimates domestic consumption of unmanufactured tobacco at nearly 227,000 metric tons in 2002, up slightly. This increase is attributed mostly to increased exports.

Cigarettes

Post estimates cigarette and papirosas consumption in 2003 at 378 billion pieces (BP), slightly less than last year. Although there is some conflicting data about cigarette consumption in Russia, the declining rate in overall domestic consumption reflects mostly higher tax policies affecting consumption by the lower income class and overall consumer health concerns. The decline in domestic consumption combined with overproduction of cigarettes has prompted tobacco companies to launch new brands and to focus on sales of better quality and filtered products with international tar and nicotine standards to attract consumers with higher purchasing power.

According to a survey by "Business Analytica" published in 2002, there are about 45 million smokers in Russia or about one third of the population. According to the survey, forty percent of smokers are between 18 and 60 years old and smoke sixteen cigarettes per day, another 32.5 percent are between 50 to 60 years and smoke up to eighteen cigarettes per day, and young people, between 18 and 29 years old, smoke an average 13.5 cigarettes per day. It is estimated that forty-six percent of the population between the ages 30 and 39 are regular smokers, and a fifth of all smokers prefer light cigarettes. The survey also revealed that smoking rates among adolescents have been increasing, especially among girls residing in urban areas. Most surveys in Russia are conducted in large cities such as Moscow and St. Petersburg as smoking is higher in cities.

Trade

Unmanufactured Tobacco

Exports of unmanufactured tobacco reached 1,250 metric tons in 2002, up twelve percent from the previous year. The value of exports of reconstituted tobacco, tobacco extracts, and essences was \$41.7 million and the largest exporters were Phillip Morris International (PM) and Japan Tobacco International (JTI).

The current outlook for tobacco exports in 2003 calls for another increase of twelve percent. The main factor contributing to this optimistic outlook is overproduction in the domestic market which is resulting in strong competition between Russian owned tobacco companies and multinationals. Russian companies are not able to compete with international giants due to the lack of capital investments and poor equipment. In the next two to three years, about 40-50 of the smaller tobacco plants will likely go out of business or be absorbed by large, firmly entrenched companies. In addition, local producers will face strong competition from other European producers.

According to official data, Russia imported 307,900 metric tons of unmanufactured tobacco in 2002, up almost ten percent. About 75 percent of all imports are Oriental type and more than twenty percent are tobacco essences. According to the State Customs Committee, imports from the U.S. decreased from 23,450 metric tons in CY 2001 to 16,675 metric tons in CY 2002. The major tobacco exporting countries to Russia in 2002 were: Brazil, China, India and Kyrgyzstan, which accounted for about forty-two percent of all tobacco imports. Imports will

continue to grow in the coming years since domestically produced Russian tobacco is of low quality and the largest companies import most raw material from other countries.

Cigarettes

Cigarette imports are decreasing but at a moderate rate due to firm domestic demand for higher quality cigarettes. Post revised its import estimates for 2002 from five BP to 6.2 BP to reflect new official data obtained from the State Customs Statistics Service. Post's current forecast for imports in 2003 calls for a return to five BP because of increased unsold stocks and major investments by larger international companies in modernization and technical equipment which will enable them to produce domestically cigarettes in compliance with international standards.

Export of cigarettes continue to increase. Official data shows cigarette exports in 2002 at five BP, more than double 2001 levels. Post estimates that cigarette exports in 2003 will likely increase by forty percent due to the current overproduction and strong domestic competition among local manufacturers. According to the Tobacco Association "GrandTabak", 70 percent of all cigarette exports were to CIS countries followed by 21 percent to Mongolia. The remaining exports were to Israel, Arab Emirates, Yugoslavia, and Turkey.

Trade sources estimate that a considerable amount of cigarettes (30 to 50 billion) are not included in official annual export figures, mostly to CIS and Baltic countries. According to Custom Committee data, the number of incidents of unreported shipments of cigarettes have only decreased slightly. In 2002, there were as many as 486 cases identified by State Customs Services, twelve were imported cigarettes and the other 474 were for export. It is estimated that more than ninety percent of all unreported cases of tobacco trade were shipped by truck. Since the beginning of 2003, 7,195 BP were detained on the Russian- Polish border and 373,580 pieces at the border with Lithuania. The Sate Customs Committee is improving its supervision logistics to have more control over the unreported trade of tobacco products on the border points.

Stocks

Unmanufactured Tobacco

There is no official data on the stocks of unmanufactured tobacco. Post estimates ending stocks of unmanufactured tobacco will increase in 2003 to 11,000 metric tons due to the current overproduction of tobacco products in Russia.

Cigarettes

Post includes cigarette stocks (unsold cigarettes by the end of the year) in consumption data. According to the Association "GrandTabak", estimated unsold cigarettes at the end of CY 2002 were 85 to 100 BP. Overproduction of cigarettes could lead to price wars between the tobacco producers and could stimulate higher exports.

Policy

Excise Taxes

Excise duties on tobacco products are a vital source of income for the state budget and were 9.5 billion rubles (\$316 million) in 2002. Last year, excise taxes were increased by twelve percent, in accordance with the rate of inflation, from the 2001 level. As of January 2003, the tobacco excise tax increased to 70 percent, when the so-called "mixed" rate (a combination of specific tax and ad valorem tax) came into force. There were heated arguments over the new excise system as the introduction of an ad-valorem tax (5%) increases the prices for cigarettes in proportional to their value. Major international companies such as Philip Morris, JTI and Gallaher, which control over fifty percent of the tobacco market, were against to the new "mixed" excise rate as these companies produce "expensive" tobacco products. As a result of the new system which increases import costs, most Russian tobacco manufacturers, which are facing financial difficulties, will be more likely to see increased profits.

On January 1, 2003, the new GOST (official state standard) 3935-2000 "Cigarettes: General Technical Specifications" came into force and changed the division of cigarettes into only two classes, filtered and unfiltered. Under the new system, cigarettes of all brands produced either domestically or overseas must correspond to the new requirements and the new "mixed" excise rate would be applied on just these two groups.

The Ministry of Taxes introduced a new mechanism late last year for collection of excise taxes with all of the tax going to the federal budget, replacing the system; where half went to federal budget and the other half to the corresponding regional budget. Tobacco products are made in twenty constituent Russian regions, however, the main capacities are concentrated in seven regions (Petersburg, Yaroslavl and Rostov are the top three).

Table 3. New and Old Excise Taxes for Tobacco Products, 1999-2003

Commodity	HS codes	Excises (1999), rubles	Excises (2000), rubles	Excises (2001), rubles	Excises (2002), rubles	Excises (2003), rubles
Pipe tobacco (Russian GOST standard)		16 R per 1 kg	32 R per 1 kg			N/A
Smoking tobacco, except tobacco which is used as raw material for manufactured tobacco products	from 2403 10 100 0	72.0 R per 1 kg	144 R per 1 kg	166 R per 1 kg		N/A
Pipe tobacco (except pipe tobacco Russian GOST standard)*	from 2403 10 100 0 from 2403 10 900 0	168.0 R per 1 kg	336 R per 1 kg	405 R per 1 kg		N/A
Cigars (except Russian GOST standard cigars)	from 2402 10 000 0	3.60 R per piece	7.2 R per piece	10.0 R per piece	11.2 R per piece	N/A

Cigars (Russian GOST standard)		1.20 R per piece	2.4 R per piece			N/A
Cigarillos and filter cigarettes over 85 millimeters long	from 2402 10 000 0 from 2402 20	30.0 R per 1,000 pieces	60.0 R per 1,000 pieces	75.0 R per 1,000 pieces	84.0 R per 1,000 pieces	50.0 R per 1,000 pieces plus 5% of value
Filter cigarettes (except cigarettes over 85 mm long and GOST grade 1, 2, 3 and 4 cigarettes)	from 2402 20	20.50 R per 1,000 pieces	41.0 R per 1,000 pieces	55.0 R per 1,000 pieces	61.6 R per 1,000 pieces	50.0 R per 1,000 pieces plus 5% of value
Filter cigarettes (GOST grades 1, 2, 3)		14.50 R per 1,000 pieces	29 R per 1,000 pieces	35.0 R per 1,000 pieces	39.2 R per 1,000 pieces	50.0 R per 1,000 pieces plus 5% of value
Filter cigarettes (GOST grade 4)		9.50 R per 1,000 pieces	19 R per 1,000 pieces	35.0 R per 1,000 pieces	39.2 R per 1,000 pieces	50.0 R per 1,000 pieces plus 5% of value
Cigarettes without filter	from 2402 20	7 R per 1,000 pieces	7 R per 1,000 pieces	10.0 R per 1,000 pieces	11.2 R per 1,000 pieces	19.0 R per 1,000 pieces plus 5% of value
Papirosas (grade 1)	from 2402 20	4.80 R per 1,000-pieces	4.8 R per 1,000 pieces	10.0 R per 1,000 pieces	11.2 R per 1,000 pieces	19.0 R per 1,000 pieces plus 5% of value

Source: Rossiyskaya Gazeta, August 2002

Other Government Regulations

The State Customs Committee Order #1205/112 dated December 26, 2002, introduced new procedures for excise marks for tobacco and tobacco products imported into the Russian Federation. All unmanufactured tobacco, cigarettes, and cigarillos now have to have an obligatory marking that is on each package and inseparable from the product. According to the State Customs Committee, the introduction of new marking will serve to both increase custom payments to the budget and oust illegal companies that import products to Russia in violation of Customs Regulations.

As of July 22, 2002, another governmental regulatory measure was announced by the Russian Government. The measure calls for obligatory licensing of tobacco manufacturing companies. The Ministry of Taxes was designated to supervise licensing of tobacco manufacturing companies and to make sure they are in compliance with the State standards and technical conditions. Both measures are aimed at legalizing the status of tobacco companies and to gain better control over tobacco trade.

Quality, Safety and Health

In addition to the Federal Law "On Limiting Tobacco Smoking" signed by the President of the Russian Federation on July 10, 2001, (see GAIN report #RS2014 of 2002), the Ministry of Health issued Order #117 dated May 17, 2002, with a list of additional warnings on the cigarette pack. In addition to the main warning, which reads "Ministry of Health warns that smoking is harmful to your health", there are five more warnings: "Smoking is the reason for cancer diseases"; "Smoking is the reason for mortal diseases"; "Protect children from smoke"; "Smoking causes nicotine dependence"; and, "Smoking is the reason for heart disease". Russians may still smoke more than all other Europeans, but recent private surveys show that a growing number of Russians (about 52 percent) have a negative attitude toward smoking and smokers, and seventy percent object to smoking in public places.

Marketing

Russia is considered the fourth largest cigarette market in the world after China, the U.S., and Japan. Trade sources estimate, that despite the increases in excise taxes, retail prices in 2003 will be more stable because of three consecutive years of cigarette overproduction and intense competition among manufacturers. The outlook for the next three to five years is product differentiation in the market, with international companies located in Russia investing more in their production capacity to produce better quality products, including substitution of imported popular brands.

According to the Association "GrandTabak", between forty to fifty tobacco companies will likely be liquidated in the near future because of stronger competition from Western companies. Other smaller ones will likely be consolidated into large holdings with their own distribution chains as most Russian tobacco manufacturers do not have their own distribution chains and are dependent on regional and local wholesale companies. Transnational companies are likely to purchase dealer chains from their present main distributors and regional and local wholesalers are likely to go through merging. According to trade sources, these are important and necessary steps in view of Russia's access to the WTO. It is thought that these international companies entering the market could radically change the distribution system in the country.

According a business survey conducted in January 2003 by "Business Analytica," more than two thirds of cigarette sales in Russia have been controlled by transnational companies. From the latest information obtained from trade sources, the market share of different tobacco manufacturers in the Russian retail market for tobacco products is as follows: Phillip Morris (23.8 percent), JTI (15.3 percent), Gallaher (14.1 percent), B.A.T. (13.8 percent), Balkan Star (7.8 percent), Don Tabak (7.7 percent), Reemsta (4.5 percent), other local companies (11.8 percent), and other international companies (1 percent).

According to "Business Analytica", the top ten most popular cigarette brands in Russia are:

Cigarette brands	Market Share (Percent)
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Marlboro	54.2
Prima (without filter)	52.6
Petr I	52.1
L&M	47.9
Golden Yava	43.6
Bond Street	38.0
Yava	34.2
Camel	32.3
Winston	31.2
LD	28.1

Table 4. Unmanufactured Tobacco Supply and Demand, Hectares and Metric Tons

PSD Table						
Country:	Russian Federation					
Commodity:	Tobacco, Unmfg.					

	2001		2002		2003	
	Old	New	Old	New	Old	New
Market Year Begin		01/2001		01/2002		01/2003
Area Planted	2000	2000	2100	2100	0	2200
Beginning Stocks	1800	1800	1900	1600	0	2000
Farm Sales Weight Prod	1600	1600	1900	1500	0	2000
Dry Weight Production	1500	1500	1800	1400	0	1900
U.S. Leaf Imports	17000	23450	25200	16675	0	1700
Other Foreign Imports	282800	284050	282300	291225	0	301700
TOTAL Imports	299800	307500	307500	307900	0	303400
TOTAL SUPPLY	303100	310800	311200	310900	0	307300
Exports	0	690	0	1250	0	1400
Dom. Leaf Consumption	1500	1700	1500	1800	0	1900
U.S. Leaf Dom. Consum.	10000	16510	23400	15850	0	12000
Other Foreign Consump.	290000	290300	284400	290000	0	290000
TOTAL Dom. Consumption	301500	308510	309300	307650	0	303900
TOTAL Disappearance	301500	309200	309300	308900	0	305300
Ending Stocks	1600	1600	1900	2000	0	2000
TOTAL DISTRIBUTION	303100	310800	311200	310900	0	307300

Table 5. Oriental Tobacco Supply and Demand, Hectares and Metric Tons

Production Table						
Country:						
Commodity:	Oriental					
		2001		2002		2003
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	2000	2000	2100	2100	0	2200
Beginning Stocks	10000	10000	10000	10000	10000	11000

Table 6. Exports of Unmanufactured Tobacco

Export Trade Matrix			
Country:		Units:	mt
Commodity:			
Time period:			
Exports for	2001		2002
U.S.	0	U.S.	0
Others		Others	
Moldova	545	Ukraine	850
Ukraine	125	Moldova	200
		Belorus	150
Total for Others	670		1200
Others not listed	20		50
Grand Total	690		1250

Table 7. Imports of Unmanufactured Tobacco

Import Trade Matrix			
Country:		Units:	metric tons
Commodity:			
Time period:			
Imports for	2001		2002
U.S.	23450	U.S.	16675
Others		Others	
China	32095	Brazil	46162
Brazil	29700	China	33655
India	27010	India	28978
Kyrgystan	25000	Kyrgystan	21582
Moldova	21530	Greece	16821
Zimbabwe	12545	Italy	15642
Azerbaijan	12310	Zimbabwe	13343
Italy	11930	Turkey	11356
Greece	11270	Azerbaijan	11303
Indonesia	11065	Moldavia	10452
Total for Others	194455		209294
Others not listed	89585		86181
Grand Total	307490		312150

Table 8. Unmanufactured Tobacco Prices

Prices Table					
Country:					
Commodity:					
Year:	2002				
Prices in (currency)	US dollars	per (uom)	Metric ton		
Year	2001	2002	% Change		
Jan	1869	1752	-6.3%		
Feb	1859	1729	-7.0%		
Mar	1967	2330	18.5%		
Apr	1912	1977	3.4%		
May	1673	1833	9.6%		
Jun	1776	1867	5.1%		
Jul	1765	1801	2.0%		
Aug	1906	2010	5.5%		
Sep	1716	2073	20.8%		
Oct	1989	1719	-13.6%		
Nov	1981	1914	-3.4%		
Dec	2004	1863	-7.0%		

Table 9. Cigarette Supply and Demand, Million Pieces

PSD Table						
Country:	Russian Federation					
Commodity:	Tobacco, Mfg., Cigarettes					
		2001		2002		2003
	Old	New	Old	New	Old	New
Market Year Begin		01/2001		01/2002		01/2003
Filter Production	215000	260000	261000	275000	0	280000
Non-Filter Production	100000	114000	114000	106800	0	100000
TOTAL Production	315000	374000	375000	381800	0	380000
Imports	15000	7100	5000	6200	0	5000
TOTAL SUPPLY	330000	381100	380000	388000	0	385000
Exports	1000	3200	5000	5000	0	7000
Domestic Consumption	329000	377900	375000	383800	0	378000
TOTAL DISTRIBUTION	330000	381100	380000	388000	0	385000

Table 10. Cigarette Exports

Export Trade Matrix			
Country:		Units:	MLN PCS
Commodity:			
Time period:			
Exports for	2001		2002
U.S.	0	U.S.	0
Others		Others	
Ukraine	1600	Belorus	2081
Mongolia	350	Ukraine	1350
Kazakhstan	300	Moldavia	310
Yugoslavia	60	Armenia	287
Kyrgyzstan	50	Kazakhstan	157
Turkmenistan	40	Mongolia	144
Arab Emirates	35	Turkmenistan	70
Moldova	25	Kyrgystan	50
Israel	20	Lithuania	34
Latvia	10		
Total for Others	2490		4483
Others not listed	65		517
Grand Total	2555		5000

Table 11. Cigarette Imports

Import Trade Matrix			
Country:		Units:	MIL PCS
Commodity:			
Time period:			
Imports for	2001		2002
U.S.	2610	U.S.	1737
Others		Others	
UK	2300	UK	2033
Germany	1250	Germany	1252
Ukraine	350	Japan	434
Japan	230	Netherlands	307
Netherlands	200	Finland	150
Denmark	60	Ukraine	27
Greece	40		
Switzerland	30		
Poland	25		
Total for Others	4485		5940
Others not listed	390		260
Grand Total	7485		6200

Table 12. Cigarette Prices

Prices Table					
Country:					
Commodity:					
Year:	2002				
Prices in (currency)	US dollars	per (uom)	1,000 pieces		
Year	2001	2002	% Change		
Jan	11.21	15.6	39.2%		
Feb	17.47	14.51	-16.9%		
Mar	13.77	15.59	13.2%		
Apr	14.06	15.31	8.9%		
May	12.98	15.62	20.3%		
Jun	13.83	15.59	12.7%		
Jul	15.01	15.49	3.2%		
Aug	14.96	14.53	-2.9%		
Sep	13.52	16.67	23.3%		
Oct	15.14	16.78	10.8%		
Nov	14.33	15.18	5.9%		
Dec	14.17	16.04	13.2%		