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Tobacco and Products

Annual Report

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Report Highlights:

Total consumption and imports of tobacco leaf in 2004 are forecast to remain unchanged from 2003 with Taiwan's cigarette consumption expected at approximately 41.5 billion pieces. The market share of local brands has fallen below 50 percent because of changing tastes and increasing PRC cigarette imports that began in 2003.

Includes PSD Changes: Yes
Includes Trade Matrix: Yes
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Executive Summary

Total consumption and imports of tobacco leaf in 2004 are forecast to remain unchanged from 2003 with a consumption level of approximately 41.5 billion cigarette pieces. The market share of local brands has fallen below 50 percent because of increasing PRC cigarette imports that began in 2003 along with changing tastes.

As a result of WTO entry, Taiwan dismantled its tobacco monopoly in January 2002. The former monopoly Taiwan Tobacco and Wine Board (TTWB) was corporatized in July 2002 and renamed as the Taiwan Tobacco and Liquor Corporation (TTLC). Although it still is a state-run corporation, privatization is expected by 2005. The old monopoly tax on cigarette imports (NT\$830 per 1000 pieces) was replaced with an import tariff (27 percent ad valorem) and an excise tax (NT\$ 590 per 1,000 pieces). In addition, an additional health tax surcharge of NT\$250 per 1,000 pieces is now assessed on cigarettes. Cigarettes are also assessed the standard 5 percent value-added tax.

Increasing taxes have pushed up prices for the mainstream brand cigarettes, both domestic and foreign brands, NT\$10 (approximately \$ 0.28) per pack higher than under the monopoly system. In addition, the health tax surcharge will likely soon be doubled to NT\$500 per 1,000 pieces once revisions to the Tobacco Hazard Prevention Act (THPA) pass the Legislative Yuan (LY) as expected later in 2004. To stay in business, the former tobacco monopoly has been slowly ending its costly Taiwan tobacco production contracts to phase out domestic production. As a result, domestic tobacco leaf production is expected to continue falling and increasingly be replaced by imports. Tobacco imports from the United States consist mostly of high quality flue-cured tobacco while tobaccos from other origins are a mix of low and high quality blended flue-cured tobaccos. With the increasing popularity of Japanese type cigarettes, Taiwan has shifted to imports of *burley* and *oriental* tobacco.

Note: The current exchange rate \$1 = NT\$33.4

Situation and Outlook, Unmanufactured (Flue-Cured)

Production

Taiwan only produces *flue-cured* tobacco with 2004 planted area forecast at 2,000 hectares. This small area makes it likely that Taiwan will end flue cured tobacco production after this year. As of June 2004, local tobacco farmers were still negotiating with the Taiwan Tobacco and Liquor Corporation (TTLC) over target production and purchase price before planting season begins in August. TTLC is trying to end domestic tobacco production because domestically produced tobacco is very expensive – only Japan has higher prices. As of 2004 only three cigarette factories remained in Taiwan while all remaining tobacco processing facilities were moved to one cigarette factory in central Taiwan.

Tobacco production area in 2003 was 2,196 hectares, down by 23 percent from 2002. The farm sales weight production was 5,429 mt, down by 28 percent from a year earlier. The TTLC tobacco purchase price was NT\$170/kg or \$5.08/kg for grade 1 to grade 3, and NT\$119.98/kg or \$3.59/kg for grade 4 and grade 5. TTLC only accepts grade 1-grade 5 tobacco. Prices paid are down substantially from the once prevalent pre-WTO price of NT\$192/kg or \$5.75.

Consumption

Total tobacco consumption in recent years has been affected by higher taxes and prices resulting from Taiwan's WTO accession. Hoarding in advance of anticipated tax hikes has also affected consumption. Total consumption surged 6 percent in 2001, on the eve of WTO accession, as consumers stockpiled cigarettes. In 2002, demand dropped by 8 percent below 2000 levels. In 2003, tobacco consumption recovered to approximately 17,000 mt, as stocks accumulated by consumers in 2001 ran out. Cigarette production in 2004 will be slightly lower than in 2003, possibly indicating the start of a gradual long-term decline.

Taiwan's falling cigarette production is not only a result of high costs, but can be partially attributed to increasing PRC cigarette imports and changing tastes. In general, Taiwan produces English type cigarettes and small quantities of American or Japanese blend cigarettes, often referred to as blend type cigarettes. In 2001, Taiwan began shifting to the production of more blend type cigarettes, which is expected to increase consumption of *burley* and *oriental* tobacco. However, lack of data makes it difficult to determine the proportions of tobacco consumption met by flue-cured tobacco versus other tobaccos. Taiwan Customs classifies tobacco imports into *flue-cured* tobacco and "other type" tobacco because TTLC has a policy of not releasing information that is now considered business confidential.

The consumption of expanded tobacco and tobacco stems has been growing because these products are lower in tar and nicotine. In 2002 TTLC started its production of expanded tobacco with a monthly capacity of 2,000 kg. Expanded tobacco is manufactured solely from Taiwan tobacco. Consumption of both Taiwan and imported tobacco stems is included in the domestic *flue-cured* consumption number because TTLC does not separate tobacco stem consumption by source. An estimated 65 percent of total tobacco consumption is stemmed/stripped tobacco, of which about 35 percent is domestic, 30 percent is from the U.S., and the remaining 35 percent is from other seven foreign sources. U.S. tobacco remains an essential ingredient of the TTLC cigarette formulations because of its unique quality characteristics. Tobacco imported from non-U.S. sources are categorized into a lower quality category that is blended with other quality grades and Taiwan grown products.

Trade

Imports

Total tobacco imports in 2003 rose 12 percent mostly because of falling domestic production while the U.S. tobacco accounted for 46 percent of imports. Tobacco imports in 2004 should be close to 2003 levels with U.S. *flue-cured* forecast to take a 50 percent import share. Because U.S. tobacco is considered the basic ingredient of TTLC cigarette formulations, it is competitive with tobacco imported from other countries.

Tobacco leaf imports are primarily *flue-cured* with small amounts of *oriental* imports from Balkan and Mediterranean countries and some burley from the United States, Brazil, and Malawi. Taiwan has been increasing imports of burley in recent years. In 2003, *flue-cured* tobacco imports accounted for 79 percent of total imports, an 8 percent fall from a year earlier, while *oriental* tobacco accounted for 5 percent of imports. The remaining 16 percent was burley. The 2003 *burley* imports from the U.S. were estimated at 932 mt. Higher import and consumption forecasts for *oriental* are also a result of increasing blend type cigarette production. The consumption shares of *burley*, *oriental* and *flue-cured* tobaccos are not available. In addition to increasing import demand for burley, imports of homogenized or reconstituted tobacco in 2003 rose 220 percent from a year earlier.

Exports

In 2003, Taiwan successfully exported tobacco to Ukraine, its first major success in exporting tobacco. Generally, TTLC uses the best quality domestic *flue-cured* tobacco to manufacture cigarettes and attempts to export the rest. In recent years, high prices and low quality have basically ended exports. Since Taiwan tobacco is not internationally competitive, the export forecast for 2004 is zero.

Tariff Changes

The current preferential tariffs on tobacco leaf, stems, and refuse are all at 17 percent. The tariff rate for manufactured tobacco products or manufactured tobacco substitutes, such as homogenized tobacco sheets, expanded tobacco leaves, tobacco extract and essences, is 20 percent.

Stocks

Tobacco stocks are still very high because of the effects of pre-WTO guaranteed purchase contracts with farmers and of Taiwan's hard to export surplus. Stocks are expected to slowly decline because of falling plantings and possible limited cigarette exports.

Marketing

Taiwan's tobacco leaf imports are stemmed/stripped tobacco. TTLC has closed its two standalone tobacco processing plants and moved its tobacco processing facilities to cigarette factories.

Situation and Outlook, Manufactured (Cigarettes)

Production

Since Taiwan opened its cigarette market to Japanese brands in 1993, the market share held by local brands has declined continuously to less than 50 percent of the market. As import penetration rose, TTLC's annual cigarette production capability shrank to 27 billion pieces with 2003 production at 20.5 million pieces. Although 2004 production is forecast to remain steady, in later years, production is expected to further contract because of higher PRC imports. In 2003, cigarette imports from PRC and Hong Kong doubled compared to a year earlier.

To counter the declining market share for its products, the TTLC is removing old brands that are not doing well and developing new cigarette types (e.g., menthol, light, mild brands, etc.). It also has introduced new packaging (e.g., hard pack boxes), and new presentations (e.g., 100 mm cigarettes) to compete with popular foreign brands and to target young smokers who prefer imports. Currently, the most popular domestic brand is still *Long Life*. To boost its share of the blended market, TTLC introduced *Long Life Gentle*, which has done well in the market so far. TTLC has also targeted *Mild Seven* by creating its own blend type cigarettes. In 2003, TTLC launched its new "9-21" brand in commemoration of the devastating September 21, 1999 earthquake in central Taiwan that killed more than 2,000 people. Some of the money earned from 9-21 will go to charity. The brand will be high quality and high priced, around NT\$60 per pack.

TTLC is also gradually reducing the tar and nicotine content of existing brands. This is not only because foreign brands are generally lighter than domestic brands, but also because

cigarettes must meet the tar and nicotine requirements of the Tobacco Hazards Prevention Act (THPA), which became law in September 1997. By July 2001, tar levels must be below 15 mg and nicotine levels below 1.5 mg. By July 2007, tar and nicotine levels must be below 12 mg and 1.2 mg respectively. Although the tar/nicotine content of most domestic brands vary considerably, they no longer cluster around the high 14 mg/1.4 mg and 11 mg/1.1 mg.

Since 1995, the Taiwan Department of Health (DOH) has conducted inspections monitoring cigarette tar and nicotine. According to DOH, all cigarettes currently sold on Taiwan are in compliance with the July 2001 requirements.

Consumption

Although the THPA took effect in 1997, it will be made more stringent in the years to come. The THPA designated several new types of public areas as smoke-free zones while imposing further limits on cigarette advertising. The Department of Health (DOH) initiated an amendment further strengthening the THPA by increasing the health tax surcharge to NT\$10 per pack from the current NT\$5. The bill passed the first reading in May 2003 and is still awaiting approval of the Legislative Yuan. It is expected to pass the Legislative Yuan quickly because it incorporates ideas from the Framework Convention on Tobacco Control that was unanimously adopted by the 192 members of the World Health Organization in May 2003. Despite the increasingly stringent THPA and higher priced cigarettes, Taiwan's cigarette consumption level in 2004 is forecast at 41.5 billion pieces -- with foreign brands taking approximately 51 percent share of the market. Future cigarette consumption is forecast to remain at around 41.5 billion pieces in the next 1-2 years but will likely slowly decrease thereafter.

A recent NGO survey showed that 47 percent of men smoke, which is unchanged from 1999. Only four percent of women smoked, a one percent drop from 1999. (The survey used a World Health Organization definition of smoker as an individual who smokes daily or occasionally and is 18 or older)

Trade

Imports

Reportedly, cigarette imports in 2003 exceeded actual market demand because of hoarding before the health tax surcharge increase from NT\$5 to NT\$10 per pack. The total cigarette import forecast for 2004 is forecast at 21.5 billion pieces, down 4 percent from 2003. The top four supplying countries were unchanged in 2003 and are expected to remain the same in 2004. These suppliers account for 88 percent of imports, a 2 percent drop from a year earlier. The top four supplying countries include Japan (54%, down by 2% from 2002), Germany (17%, up by 1% from 2002), the United Kingdom (8%, unchanged), and the United States (9%, down 1% from 2002). U.S. imports in 2004 are forecast at 1.9 billion pieces, 9 percent of the total imports. The best selling foreign brands are Japanese *Mild Seven* and U.S. brands *Marlboro* and *Parliament*. On February 2002, Taiwan lifted the import ban on PRC cigarettes. However, PRC cigarettes only arrived on the Taiwan market after a year-long delay because China refused to recognize TTL's *Long Life* brand. The leading PRC brand cigarette was launched on the Taiwan market in April 2002 and priced at NT\$120 per pack. Other PRC brands are priced at the same level as domestic mainstream brands at around NT\$35 per pack. In 2003, cigarette imports from PRC and Hong Kong combined doubled from a year earlier.

Exports

In 2003, Taiwan's cigarette exports accounted for 2 percent of production, a 2 percent decrease from a year earlier. Exports are forecast to increase because of TTLC's drive to export to the PRC as compensation for the loss of local market share to Chinese brands. However, exporting and promoting cigarette to trade restrictive state-trading oriented PRC is not easy.

Tariff Changes

When monopoly control ended with WTO accession on January 1, 2002, the associated tax on cigarette imports was replaced with an import tariff (27 percent ad valorem) and an excise tax (NT\$590 per 1,000 pieces). A new health tax surcharge of NT\$250 per 1,000 pieces was also assessed on cigarettes. In addition, cigarettes are charged a 5 percent value-added tax.

Prices

After the monopoly was abolished, the mainstream retail prices for foreign brands increased NT\$10 to NT\$50 per pack. Luxury cigarettes that were priced two to three times higher than mainstream brands saw smaller or no price increases. The retail price of *Mi-Ne Prestige* remained at NT\$80 per pack while *Davidoff Magnum* was steady at NT\$150 per pack. The price gap between imported and locally produced cigarettes still is significant. The mainstream retail prices for domestic brands also increased NT\$10 to NT\$35 per pack.

Policy

Although Taiwan is not a member of the World Health Organization (WHO), it has committed to incorporate many of the guidelines contained in the WHO Framework Convention on Tobacco Control (FCTC) into domestic law and regulations. This will result in strengthening the THPA by increasing taxes and imposing more stringent controls on advertising along with more forceful labeling. Taiwan has an influential and active anti-smoking organization, the John Tung Foundation, that has closely follows developments in the FCTC.

Marketing

The total cigarette market in 2004 is forecast at 41.5 billion pieces. Foreign brand penetration is likely to further rise above 52 percent of the total Taiwan cigarette market as local brands lose out to cheaper PRC brands and higher-end imports. Japanese market share is expected to remain steady as the demand for blended type cigarette is already high. Most consumption changes in 2001 and 2002 came from the effects of WTO accession, especially the effects of hoarding in anticipation of higher taxes. The slowdown taxation changes should reduce consumption fluctuations.

Statistical Tables

Table 1. Flue-Cured Production, Supply and Demand (MT)

PSD TABLE						
Country	Taiwan					
Commodity	Tobacco, Unmfg., Total				(HA) (MT)	
	2002	Revised	2003	Estimate	2004	Forecast
	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]
Market Year Begin		01/2002		01/2003		01/2004
Area Planted	2115	2929	2115	2197	0	2000
Beginning Stocks	28836	28836	24862	27546	20888	21992
Farm Sales Weight Prod	5287	7730	5287	5500	0	5000
Dry Weight Production	5076	7300	5076	5250	0	4770
U.S. Leaf Imports	4000	5000	4000	4368	0	5000
Other Foreign Imports	4000	3460	4000	5099	0	4000
TOTAL Imports	8000	8460	8000	9467	0	9000
TOTAL SUPPLY	41912	44596	37938	42263	20888	35762
Exports	0	0	0	3221	0	0
Dom. Leaf Consumption	9898	9898	9898	9898	0	9898
U.S. Leaf Dom. Consum.	3362	3362	3362	3362	0	3362
Other Foreign Consump.	3790	3790	3790	3790	0	3790
TOTAL Dom. Consumption	17050	17050	17050	17050	0	17050
TOTAL Disappearance	17050	17050	17050	20271	0	17050
Ending Stocks	24862	27546	20888	21992	0	18712
TOTAL DISTRIBUTION	41912	44596	37938	42263	0	35762

Table 2. Total Tobacco Imports (MT)

IMPORT TRADE MATRIX			
Country	Taiwan		
Commodity	Tobacco, Unmfg., Total		
Time Period	1/2002	Units:	Metric ton
Imports for:	2002		2003
U.S.	5000	U.S.	4368
Others		Others	
Brazil	1763	Zimbabwe	1651
Greece	1073	China	1426
Malawi	344	Brazil	1113
Thailand	253	Greece	459
France	28	Malawi	421
		Turkey	21
		Vietnam	8
Total for Others	3461		5099
Others not Listed			
Grand Total	8461		9467

Table 3. Flue-Cured Tobacco Imports (MT)

IMPORT TRADE MATRIX			
Country	Taiwan		
Commodity	Tobacco, Unmfg., Flue Cured		
Time Period	1/2002	Units:	Metric ton
Imports for:	2002		2003
U.S.	4566	U.S.	3436
Others		Others	
Brazil	528	Zimbabwe	1652
Malawi	344	Brazil	596
Greece	404	Malawi	326
Thailand	253	China	1426
France	28		
Total for Others	1557		4000
Others not Listed			
Grand Total	6123		7436

Table 4. Flue-Cured Tobacco Exports (MT)

EXPORT TRADE MATRIX			
Country	Taiwan		
Commodity	Tobacco, Unmfg., Flue Cured		
Time Period	1/2002	Units:	Metric ton
Exports for:	2002		2003
U.S.		U.S.	18
Others		Others	
		Ukraine	2948
		South Africa	255
Total for Others	0		3203
Others not Listed			
Grand Total	0		3221

Table 5. Cigarette Production, Supply and Demand (Million Pieces)

PSD TABLE						
Country	Taiwan					
Commodity	Tobacco, Mfg., Cigarettes					
					(MIL PCS)	
	2002	Revised	2003	Estimate	2004	Forecast
	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]	USDA Official [Old]	Post Estimate [New]
Market Year Begin		01/2002		01/2003		01/2004
Filter Production	19383	19383	20500	20493	0	20500
Non-Filter Production	0	0	0	0	0	0
TOTAL Production	19383	19383	20500	20493	0	20500
Imports	17736	17736	20500	22273	0	21500
TOTAL SUPPLY	37119	37119	41000	42766	0	42000
Exports	741	741	850	405	0	500
Domestic Consumption	36378	36378	40150	42361	0	41500
TOTAL DISTRIBUTION	37119	37119	41000	42766	0	42000

Table 6. Cigarette Imports (Million Pieces)

IMPORT TRADE MATRIX			
Country	Taiwan		
Commodity	Tobacco, Mfg., Cigarettes		
Time Period	01/2002	Units:	million piece
Imports for:	2002		2003
U.S.	1742	U.S.	1960
Others		Others	
Japan	9880	Japan	12045
Germany	2889	Germany	3846
U.K.	1384	U.K.	1688
Malaysia	882	Malaysia	1497
Slovenia	563	Slovenia	519
Switzerland	266	Switzerland	395
China	41	China	133
Hong Kong	36	Singapore	124
		Hong Kong	26
Total for Others	15941		20273
Others not Listed	53		2000
Grand Total	17736		22273

Table 7. Cigarette Exports (Million Pieces)

EXPORT TRADE MATRIX			
Country	Taiwan		
Commodity	Tobacco, Mfg., Cigarettes		
Time Period	01/2002	Units:	Million piece
Exports for:	2002		2003
U.S.		U.S.	
Others		Others	
Hong Kong	555	Philippines	203
Philippines	154	Hong Kong	136
China	16	Singapore	25
Vietnam	4	Malaysia	21
		Vietnam	7
Total for Others	729		392
Others not Listed	12		13
Grand Total	741		405