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## **Russian Federation**

### **Cotton**

### **Cotton Update, March Lockup**

**1999**

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#### **Report Highlights:**

**Cotton imports remain low despite a recovery to pre-crisis levels in the textile industry because of increasing imports of cotton “for processing only,” which occurs when textile mills process materials that still belong to the foreign raw material suppliers. Report also profiles Ivanovo, center of the Russian textile industry.**

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## Textile Production

Domestic demand for cotton textiles began to rise from November to December 1998 because of reduced competition from imports caused by the weak ruble. According to official sources, prices of imported cotton textiles increased by 64 percent from September to December 1998, while prices of domestically produced cotton textile rose in the same period only by 43 percent. In another example, prices of cotton bedclothes also changed differently for domestic and imported goods: imported product prices rose by 45 percent in September, and by 37 percent in October, while prices of Russian bedclothes increased by 12 and 13 percent, respectively. Import substitution is not the only reason for the recovery in the textile industry: The weak ruble has also spurred textile exports by making the Russian producers more competitive internationally.

## Import Trends

Cotton imports were very low at the end of 1998. From August to December 1998, Russian Customs reported total cotton imports of 24,300 tons. The lowest monthly level was in September, when only 1,600 tons of cotton were imported. After that, imports slowly recovered and by December 1998 reached 9,000 tons. According to industry sources, December was the turning point in the slow upturn in the cotton textile industry. As a result, monthly imports of cotton may increase to 12,000-13,000 tons in January and the coming months of 1999.

However, despite some signs of recovery from the August crisis, a significant upturn in imports is not expected because of the strong U.S. dollar which makes cotton imported on commercial terms too expensive for the financially constrained Russian textile industry. In addition, the old Soviet special relationship between Uzbekistan and the Russian textile industry seems to have ended. Instead of accepting barter, Uzbekistan now demands 90 percent prepayment in hard currency for its cotton shipments to Russia -- and recent Russian government attempts to negotiate more favorable terms of supply have not been successful. This is further complicated by the fact that mills mostly sell to domestic consumers who pay in less valuable rubles. Even if Russia could afford the cotton, industry sources indicate that Uzbekistan has already sold most of its cotton abroad to companies which trade on commercial terms. Most of the remaining cotton is available in limited quantities from Kazakhstan, Turkmenistan, and Tajikistan.

## Offshore Imports and Production

Despite the return of textile production to about pre-crisis levels, little of this is likely to show up in official import data because of a dramatic expansion of the "imports for processing only" scheme. Under "for processing only," products are never officially imported because they never stop being the property of the foreign firm supplying the raw materials. As a result, the raw materials and the resulting products remain in a

customs zone while in Russia and are never counted either as exports and imports. There are several major advantages of doing this for textile firms and their suppliers: One, this saves VAT and customs duties, which can amount to 30 percent of input prices. Two, it reduces the risk of supply and market disruptions by guaranteeing both a reliable market and raw material supplies simultaneously. Three, it eliminates the need for textile mills to get credit to buy raw materials. Four, "for processing only" eliminates the foreign exchange risk for mills created when they buy inputs in hard currency only to sell finished products in devalued rubles. Therefore, because of the increase in "for processing only" the import forecast for 1998 will be cut to 110,000 tons, despite the modest recovery in the textile industry.

## **Textile Industry Policy**

Because of the dependancy of the Russian textile industry on imported raw materials and the weak ruble which is spurring domestic production, there is renewed interest in bringing in investors who can help guarantee the flow of raw materials. Because the textile industry is mostly privatized, this will require firms to search for investors instead of depending on the state. In order to facilitate these investments, some oblasts which are dependent on cotton and/or linen textile production initiated more favorable taxation policy for investors, including foreign investors, along with implementing other incentives policies.

## **Ivanovo: Center of the Russian Textile Industry**

Located about 200 miles to the northeast of Moscow, Ivanovo oblast has the greatest concentration of textile mills in Russia. Ivanovo has 43 textile firms, including 6 mills and has been a major textile center for more than a century. In total, about 70 percent of the oblast's economy comes from textiles. The region used to get cotton from Egypt and USA before the 1917 revolution but since then 99 percent of cotton used has come from Uzbekistan. During Soviet times, 25 percent of all the USSR's cotton textiles were produced in Ivanovo (and 30 percent of Russian Republic's cotton textiles). Now because the textile industry elsewhere in Russia is in worse condition than in this oblast, Ivanovo's share of Russian cotton textile production has reached 70 percent.

This does not mean the industry in Ivanovo is healthy though: At the present time, the textile industry is running at 20 percent of capacity. Firms in Ivanovo are finding it hard to source raw materials because of prices and financing. Turkmenistan is interested but terms remain a problem. To improve the relationship with Uzbekistan, the regional governor visited there recently. The regional government is very interested in investment -- in joint ventures or even in having firms bought outright. There is now little foreign investment in the textile industry. There are also plans to set up a federal center to facilitate the leasing of textile equipment to help small enterprises and investors use existing facilities and textile equipment now idled at the big textile enterprises. To ensure a steadier supply of raw materials, the oblast government and several firms are interested in investing in local flax production for linens. Raw materials are now often sourced from the EU. A final problem facing the industry in this region is the lack of loans on favorable terms and the problem with banks shying away from the textile industry. This makes it difficult for firms to modernize and buy production inputs.

**PSD, Cotton, Metric Tons, Hectares**

PSD Table						
Country:	Russian Federation					
Commodity:	Cotton					
		1996		1997		1998
	Old	New	Old	New	Old	New
Market Year Begin		08/1996		08/1997		08/1998
Area Planted	0	0	100	100	1500	1500
Area Harvested	0	0	100	100	1500	1500
Beginning Stocks	50000	50000	20000	20000	20000	20000
Production	0	0	50	50	800	800
Imports	220000	220000	285000	285000	170000	110000
TOTAL SUPPLY	270000	270000	305050	305050	190800	130800
Exports	0	0	0	0	0	0
USE Dom. Consumption	250000	250000	285050	285050	186000	126000
Loss Dom. Consumption	0	0	0	0	0	0
TOTAL Dom. Consumption	250000	250000	285050	285050	186000	126000
Ending Stocks	20000	20000	20000	20000	4800	4800
TOTAL DISTRIBUTION	270000	270000	305050	305050	190800	130800

**PSD, Cotton, Bales, Hectares**

PSD Table						
Country:					Conversion	0.004593
Commodity:						
		1996		1997		1998
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	0	0	100	100	1500	1500
Area Harvested	0	0	100	100	1500	1500
Beginning Stocks	230	230	92	92	92	92
Production	0	0	0	0	4	4
Imports	1010	1010	1309	1309	781	505
TOTAL SUPPLY	1240	1240	1401	1401	876	601
Exports	0	0	0	0	0	0
USE Dom. Consumption	1148	1148	1309	1309	854	579
Loss Dom. Consumption	0	0	0	0	0	0
TOTAL Dom. Consumption	1148	1148	1309	1309	854	579
Ending Stocks	92	92	92	92	22	22
TOTAL DISTRIBUTION	1240	1240	1401	1401	876	601