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Market Development Reports

Opportunities for US Cotton Exports to Russia

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Report Highlights:
The Russian textile industry is recovering rapidly from a deep slump in the 1990's. Textile production has grown 85 percent in 2000 and is expected to continue growing more than 10 percent annually. Growth has been spurred by increasing demand for textiles, a sharp reduction in textile imports due to the ruble devaluation in August 1998, and rising exports. At the same time, cotton production in Uzbekistan, Russia's largest supplier, is falling. This creates significant opportunities for US cotton exports.

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Executive Summary

The Russian textile industry is recovering rapidly from a deep slump in the 1990's. Russian production grew 85 percent in 2000 and is expected to continue growing 10 percent annually. The August 1998 ruble devaluation made imported textiles prohibitively expensive and the industry has found its competitiveness enhanced with domestic demand for Russian textiles growing and exports now accounting for a third of production. At the same time, cotton imports from Uzbekistan, Russia's largest supplier, are set to decline over the long run because of increasing soil salinity and diversion of land to grain production. These trends have created significant opportunities for US cotton exports. Most cotton (80 percent) is processed on a tolling basis, and the most favorable targets for potential exporters are cotton traders or others that supply raw materials to mills.

Textile Production

In 2000, the Russian textile industry is projected to produce 1.7 billion square meters of textiles, the largest total in six years. Although production still remains far below the 6 billion square meter level of the mid 1980's, Russia is now producing higher quality items in response to market demand instead of the low quality fabrics it once made for the state. The August 1998 ruble devaluation greatly enhanced Russian textile mills' competitive position vis-a-vis imported textiles. As a result, 2000 production is expected to be 85 percent above the postwar low of 900 million square meters in 1999. Production is expected to continue growing more than 10 percent annually for the next several years. This expansion is being spurred by increasing Russian textile consumption, a sharp reduction in textile imports and rising exports. Cotton consumption is expected to rebound to 370,000 tons this year, up 85 percent from 200,000 tons a year ago.

Rising Textile Consumption

Russian textile production has been buoyed by increasing demand. In the two years since the 1998 economic crisis incomes have increased giving people a chance to replace their old clothing and some home furnishings. The poor condition of the Russian clothing and textile stocks indicate a high degree of pent-up demand. Demand by the military has also increased. Some of the strongest sectors have been children's clothing, towels, stockings, pyjamas, jerseys, technical fabrics and fabrics for medical use.

Stagnant Textile Imports

Despite growing demand for textiles, yearly textile imports remained stagnant at just under 50 million square meters in 1998 and 1999 and are expected to be at the same level in 2000. As demand for textiles has grown, imports have not been able to recapture their share because of high prices. Imports from China, Central Asia and Turkey were unable to capitalize on higher demand for textiles in Russia and are likely to continue to see their market shares fall.

Higher Exports

Russia is expected to export 550 million square meters of textiles in 2000, mostly to the EU and USA. This is up 66 percent from the 1999 total of 301 million square meters. Most exports were cotton textiles for use in clothing, bed wear and curtains. Unless the ruble appreciates, Russian textile exports should continue growing.

Structure of the Textile Industry

Tolling still prevalent

The de facto termination of barter arrangements with Uzbekistan, which lasted into the late 1990's, resulted in a system of imports “for processing only” or “tolling”, an arrangement whereby textile mills never take possession of cotton but are merely paid for processing it. Although this arrangement lowers costs by allowing imports to enter free of duty and value-added tax and removes the burden on Russian mills of having to buy cotton with hard currency, it also limits a mill’s ability capture the value they add through production. Industry sources estimate that tolling accounts for 80 percent of total cotton textile production, which is down slightly from 90 percent in 1999. The importers most active in tolling are usually big trading companies based in Central Asia. They give cotton for processing to the factories, and then sell fabrics in Russia and abroad. Only a few have bought shares in textile plants.

Future Prospects

Although textile production is not expected to approach Soviet levels, it is expected to increase in line with other Russian light industries such as food processing, which are becoming increasingly competitive. Recovery will likely be slowed by a chronic shortage of investment capital, outmoded equipment and a large inefficient scale of production. Onerous rules and regulations also impede restructuring. Most problematic are high taxes and residual Soviet social obligations on plants to maintain an array of clinics, hospitals, culture centers, kindergartens, heating boilers and other welfare supports. The textile industry's high concentration in economically depressed Ivanovo Oblast is also an impediment. Additionally, the heavy preponderance of "tolling" production makes it hard for individual mills to improve their financial situations. As a result of these problems, only about 20 to 25 percent of textile firms are stable and profitable -- and these are mills that have found partners and investors, or merged with textile factories and wholesalers.

On the bright side, the devalued ruble has boosted domestic and export demand for fabrics. Although many managers remember wistfully the days of state subsidies and cheap Uzbek cotton, they are facing reality and becoming more market-oriented. This should aid the restructuring of the textile industry. In addition, as costs rise, especially in the EU, there is an increasing interest in investing in the Russian textile industry despite the risks and constraints mentioned above. In many cases, investors may set up smaller, better equipped, more modern and flexible mini-mills in the former mills. Overtime this should boost Russian textile production despite the lack of major reforms.

Trade

The ongoing recovery in the textile industry is expected to boost cotton imports. From January through September 2000, Russia officially imported over 234,000 metric tons of cotton, up 80 percent from 130,000 tons in 1999. Only 6,000 tons or 2.5 percent of the total came from outside the CIS, mostly from China and the Baltic countries.

Low Russian Cotton Production

Because of its climate, Russia can only produce a very small fraction of its cotton consumption, less than 0.5 percent. Although increasing investment in the sector is likely to push cotton production in Russia to a record 800 tons in 1999-2000 and 1000 tons in 2000-2001, this will not reduce Russian dependence on imports. Russian production is located mainly in Kalmykia, Volgograd, Astrakhan, and Stavropol. The crop is increasing because of high prices for imported cotton and support from Russian textile companies and regional governments, especially in Astrakhan and Kalmykia. However, because other crops tend to produce higher economic returns and because water available for irrigation is limited, large production increases are unlikely. Russia will remain highly dependent on cotton imports for the foreseeable future. Reflecting this, Russia's import tariff on cotton is zero.

Weakening Competition

While most cotton imports still come from Central Asian suppliers in Uzbekistan, Turkmenistan, Kazakhstan and Kyrgyzstan, Russia is diversifying its sources of supply. This partially so because the bilateral agreement with Uzbekistan is no longer in operation although it is still officially in place. In 2000, Russia is forecast to import 70 percent of its cotton from Uzbekistan, 12 percent from Kyrgyzstan, 5 percent from Turkmenistan and 1 percent from Latvia. More cotton is also coming from China and through Lithuania, which mostly resells cotton from other suppliers.

Uzbek cotton production is expected to fall to 850,000 tons this year because of bad weather, down from a 1 million ton average. This reduction will make it difficult for Uzbekistan to fill Russia's import requirements. In the years to come, it is expected that traditional suppliers in Central Asia will reduce production. Uzbekistan will likely cut the area planted to cotton to increase grain in an effort to wean itself from a heavy dependence on Kazakh grain supplies. In addition, increasing soil salinity and water shortages caused by irrigation are also expected to cut future Uzbek cotton crops.

Policy

Although the Russian government periodically expresses interest in the textile sector, significant action is not foreseen. The most recent action came when President Putin visited Ivanovo earlier in 2000 and promised to increase state demand for textile products (for social needs, law enforcement, and the military) while protecting the market against the "pirate" competition of small companies which produce clothes with false brand names. The state also promised to fight tolling in the cotton textile industry by lowering interest rates and reaching new agreements with Uzbekistan and Tajikistan on supplies of cotton lint. Other senior Russian officials have proposed bartering machinery and fertilizers for cotton and textiles. Little has come of these ideas.

Marketing

About 60 percent of Russian textile production capacity is located in Ivanovo Oblast, Russia's center for cotton and textiles. In the last three years, the oblast has attracted many commercial traders which now sell 40 percent of the cotton distributed in Russia. Most of the rest comes from traders based in Moscow and in supplying countries. Because most mills are in poor financial condition, the best markets for cotton exporters are either the traders or owners of enterprises that supply raw materials. More than half of all cotton is imported by Rostextile, a large textile holding company.

Mills do not report a shortage of raw materials but instead difficulties with terms and prices. Because of these, most production is on a tolling basis with cotton supplied by Russian traders who buy in Central Asia, China or the Baltic countries. Credit and price problems make it hard for all but the richest firms to buy on western exchanges (such as Liverpool). Most textile mills would prefer returning to the Russia - Uzbek intergovernmental agreement that removed the need to use hard currency, and give mills the chance to build a supply infrastructure without middlemen. The chances of this happening are low.

Prospects for US cotton exports

The breakdown of the Russia-Uzbek intergovernmental agreement, recent increases in local demand and increased Russian competitiveness resulting from Russia's low cost structure have created a major opening for US cotton exports to Russia.

According to estimates by top Russian cotton textile producers, demand for US cotton should be a minimum of 15,000 tons per year. The estimates are based on evaluations of potential demand for high quality fabrics and the industry's capacity to process US cotton. Although most textile mills cannot yet afford to buy US cotton, some cotton traders and the more prosperous mills may be able to. Local sources say that the largest barriers to US exports are terms and prices, because there are no duties and VAT on cotton. If suppliers ask for cash up front or are unwilling to allow payment in installments, they will not be able to sell in the Russian market. In 1996, the US exported 9.3 million dollars of cotton to Russia through GSM-102 while in 1997, it exported $7.0 million.