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Tobacco

Tobacco Annual Report

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Report Highlights:

Despite the August economic crisis, the tobacco industry remains one of the most prosperous sectors in the Russian economy. Significant carry-over stocks of unmanufactured tobacco in 1998 helped the industry through its most difficult post-crisis months, despite its dependence on imported raw tobacco. The manufactured tobacco industry was also stabilized by foreign investment that will total more than \$500 million mostly in Moscow, St. Petersburg and southern Russia over the next 2-3 years. Because of these factors, 1999 is expected to be another good year for the industry.

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

Tobacco

Despite the August economic crisis, the tobacco industry remains one of the most prosperous sectors in the Russian economy. Significant carry-over stocks of unmanufactured tobacco in 1998 helped the industry through its most difficult post-crisis months, despite its dependence on imported raw tobacco. The tobacco manufacturing industry was helped by considerable foreign investment which both stabilized the supply of imported raw materials and contributed to the uninterrupted production of high quality cigarettes at prices undercutting those of imported cigarettes. Total investments in the industry are expected to total over \$500 million over the next 2-3 years and will be concentrated in Moscow, St. Petersburg and southern Russia. However, despite these developments, the tobacco industry did not totally escape the effects of the crisis and ruble devaluation. Because the tobacco industry is very dependent on imports, prices rose considerably, shifting tobacco consumption to cheaper products. Although this may cut raw tobacco imports used in more expensive cigarettes, there will be no large net decrease in imports unless Russian consumers stop smoking, something not likely to occur in the near future. In 1999, the market is expected to remain stable at current strong levels.

Cigarettes

Both production and imports of cigarettes increased in 1998 but in 1999 imports will likely fall sharply as domestic production increases. While in 1998, these increases were possibly due to better reporting and more accurate Customs data, increased 1999 production reflects increasing investment in the sector and decreasing competition from imports. The bulk of 1998 cigarette imports entered before the August financial crises: more than 80 percent of all cigarettes (both in value and in quantity terms) came during January-August 1998. Imports in September dropped to 5,636 million pieces from 10,176 million pieces in August, and by November fell to 1,040 million pieces. However, stocks of cigarettes by the end of the year remained significant, and in spite of a lower forecast for official imports in 1999, a cigarette shortage is not expected. Because of high inflation, heavy taxation and porous borders with the CIS countries, the level of nonofficial trade of cheap cigarettes by shuttle traders is expected to be high in 1999.

Production

Tobacco

A fourfold increase in ruble prices of imported tobacco and tobacco products following the devaluation, along with better weather in 1999 may result in an increase in domestic production of tobacco to 600,000 tons. Despite a 40 percent increase in area harvested in 1998, officially reported tobacco production in Russia fell to 520,000 tons, a 20 percent cut from 1997 levels. After 2 years of rising yields, yields of tobacco fell to 0.5 tons per hectare because of bad weather, increased under-reporting of production by farmers anxious to avoid taxation, and production difficulties caused by the August financial and economic crises in Russia. Production of tobacco is concentrated in Krasnodar Kray, located in Southwest Russia between the Black and Caspian seas, where farmers deal directly with manufacturing companies. Despite local production, both joint ventures and domestic tobacco manufacturing companies depend on imported raw tobacco. The growth of domestic tobacco production is not encouraged by the government, and import tariffs for raw tobacco remain low.

Russia produces only Oriental tobacco and imports mostly the same because it is preferred by Russian smokers. Although the State Customs Committee's export and imports statistics do not separate Oriental tobacco from other types, it is possible to estimate type of tobacco imported based on country of origin. For example, imports from India, Indonesia, Turkey, and China are estimated as Oriental tobacco.

Cigarettes

Because of reduced imports and increased foreign investment, Russian cigarettes and papirosa (Russian cigarettes with a cardboard tube for a filter) production will continue to increase to 190 billion pieces. Despite more accurate production reporting, manufacturing in "shadow" enterprises remained significant, and is still estimated by industry specialists at approximately 15-20 billion pieces. More than 45 cigarette factories operate in Russia, including 20 that are less than 3 years old. However, most official production is concentrated in 27 major cigarette plants, of which 17 enterprises are part of Russia's "Tabakprom" association. Nine of the 27 major plants are partially or wholly owned by foreign companies and have been recently modernized. These plants produce 50 percent of tobacco products, which have increased the transparency of production in the industry, making the reporting of production more accurate. This increasing openness could end in 1999

because of significant post-crisis price increases of cigarettes and if Russia carries out its plan for a state tobacco monopoly intended to collect money for the federal budget. If introduced, a state monopoly could increase illegal production of papirosas and cigarettes sharply.

Unmanufactured Tobacco Production Table, by Type

Production Table						
	Area Planted			Production		
	(HECTARE S)			Metric Tons		
	1997	1998	1999	1997	1998	1999
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	700	990	900	640	520	600
Total	700	990	900	640	520	600

Source: State Customs Committee

Consumption

Tobacco

The use of tobacco in cigarette and papirosa production increased in 1998 to 181,000 metric tons. Most domestic plants, including joint ventures and foreign companies, were working close to full capacity, and many plants were planning to increase their capacity through plant modernization. Because demand for tobacco tends to be inelastic, 1999 consumption is expected to be about the same despite falling real incomes.

Most consumers prefer Oriental and semi-oriental tobacco. This is because of traditional tastes and a large, stable demand for papirosa and non-filter cigarettes in remote and rural areas and among lower income consumers -- whose number grew significantly after the crises.

Cigarettes

Potential demand for papirosas and cigarettes in Russia is estimated at 250-270 billion pieces per year. However, the crises increased consumption of lower quality and cheaper tobacco products at the expense of better quality cigarettes which resulted in the reopening of some older plants that make papirosas. While incomes remained static or fell, ruble prices of cigarettes increased 3 to 5 times from August - September 1998 and increased another 80-100 percent from October 1998 to March 1999. Prices increased both for domestically produced and imported cigarettes.

Stocks

Tobacco stocks increased in 1998 from 9,700 metric tons in the beginning of the year to an estimated 30,000 tons at year's end because of large raw tobacco imports from before the economic crisis. Because of slow imports after August 1998, continuing high cigarette production will likely draw down stocks considerably in 1999.

Trade

Tobacco

Exports and re-exports of tobacco are not significant, and fell in 1998 to mere 600 metric tons. However, imports of tobacco increased. Most tobacco (more than 60 percent) was imported in January-June, 1998, when average monthly imports were 20,000-22,000 metric tons. In September through December 1998, unlike earlier years, average monthly imports decreased to 10,000 metric tons. In December 1998 - February 1999 average imports recovered slightly to 14,000 metric tons. Tobacco leaf imports from the U.S. increased almost threefold and reached 4,460 metric tons in 1998. These imports supplied production of U.S. and other joint venture tobacco manufacturing plants in Russia. In 1999, Post forecasts some decrease in expensive tobacco imports, including from the U.S., and the strengthening trade with suppliers of cheap tobacco from the CIS and developing countries such as India. Total 1999 official imports of tobacco will probably not exceed 155,000 metric tons.

Cigarettes

Official exports of Russian cigarettes decreased in 1998 to 1.5 billion pieces but may rise to 2.5 billion pieces in 1999 because of attractive hard currency prices. Because of the ruble devaluation, official cigarette imports in January-February 1999 were 6 times lower than in January-February 1998. However, a correct final estimation of imports will be difficult in 1999 because the share of products traded outside official channels will increase. Official cigarette imports are forecast to fall 32 percent from 65 billion pieces in 1998 to a 44.5 billion in 1999. The decline in cigarette imports after the August economic crisis hit U.S. tobacco firms especially hard because they were the largest suppliers of quality cigarettes into the Russian market. However, these tobacco firms have long ago started joint venture cigarette production in Russia with imported raw material, and their losses in imported cigarettes trade will be compensated by increased local production.

Tariffs

Import tariffs for most tobacco products remained unchanged in 1998 although in April 1999, import tariffs for homogenized or reconstituted tobacco (HS code 2403 91 000) fell from 30 to 20 percent. Duties for imported unmanufactured tobacco remain 5 percent, making imported raw tobacco competitive in the Russian market. However, imported cigarettes will not do so well because they face high tariffs. This imbalance between raw tobacco and cigarette imports is further skewed by the fact that unmanufactured tobacco products (HS code 2401) are also eligible for lower tariff rates if they come from the developing countries while cigarettes and other tobacco products are not included in these preferences. Domestic producers are also trying to boost their industry by lobbying for a government resolution that would decrease import duties on equipment and other supplies used in tobacco manufacturing.

Import tariffs for unmanufactured tobacco and manufactured tobacco products are given in the table below.

HS CODE	COMMODITY	IMPORT TARIFF
2401	Unmanufactured tobacco, tobacco refuse	5 percent
2402	Cigars, cigarillos and cigarettes, of tobacco or of tobacco substitutes	30 percent, but not less than 3 Euro for 1,000 pieces
2403	Other manufactured tobacco and manufactured 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

SOURCE: Russian State Customs Committee

In addition to tariffs, all imported cigarettes are subject to a 20 percent Value Added Tax.

Imports of tobacco and tobacco products from CIS countries are free of import tariffs. Exemptions in payments of VAT at the border exist only for CIS countries, which have a special intergovernmental agreement with the Russian Federation.

Marketing

Russia tightened up control over tobacco imports with the passage in December 1998 of Government Resolution (#1471 of December 7, 1998) that imposes a licencing scheme on imports of tobacco. Although the licenses are not subject to a quota, they create administrative or organizational problems for importers. Without the licences, the State Customs Committee will refuse to allow the entry of imported products.

Several other resolutions are under consideration by the Federal government that would require special stamps to identify domestically produced cigarettes and other tobacco items; that would require federal licences for tobacco production and that would create a federal center to evaluate tobacco product quality and safety. The regions are also trying to establish control over the trade of cigarettes and tobacco products. For example, the Moscow City government wants to supervise this trade through “Mostabak”. However, none of these resolutions have been passed.

Russia has also increased the excise tax on tobacco products. The changes were outlined in Russian Federal Law of December 29, 1998 “On immediate measures in the budget and taxation policy” and are given in the table below.

New and Old Excise Taxes for Tobacco Products, 1998-1999

Commodity	Excises (1998), rubles	Excises (1999), rubles
Pipe tobacco (Russian GOST standard)	n.a.	16 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
Pipe tobacco (except pipe tobacco Russian GOST standard)	140.0 R per 1 kg	168.0 R per 1 kg
Cigars (except Russian GOST standard cigars)	3.0 R per piece	3.60 R per piece
Cigars (Russian GOST standard)	1.0 R per piece	1.20 R per piece
Cigarillos and filter cigarettes over 85 millimeters long	25.0 R per 1,000 pieces	30.0 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
Filter cigarettes (GOST grades 1, 2, 3)	n.a.	14.50 R per 1,000 pieces
Filter cigarettes (GOST grade 4)	n.a.	9.50 R per 1,000 pieces
Cigarettes without filter	6.0 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

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). As stated in the previous annual report, most cheaper tobacco products do not meet safety requirements on tar and nicotine which makes trade in them of dubious legality.

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

PSD Table						
Country:	Russian Federation					
Commodity:	Tobacco, Unmfg.					
		1997		1998		1999
	Old	New	Old	New	Old	New
Market Year Begin		01/1997		01/1998		01/1999
Area Planted	700	700	650	990	0	900
Beginning Stocks	1130	1130	9770	9700	0	30000
Farm Sales Weight Prod	640	640	600	520	0	600
Dry Weight Production	600	600	560	500	0	560
U.S. Leaf Imports	1600	1600	2200	4460	0	4000
Other Foreign Imports	183300	183300	175800	196440	0	158000
TOTAL Imports	184900	184900	178000	200900	0	165000
TOTAL SUPPLY	186630	186630	188330	211100	0	195560
Exports	1760	1700	1000	640	0	0
Dom. Leaf Consumption	2030	1730	6500	500	0	560
U.S. Leaf Dom. Consum.	1500	1500	2100	4460	0	4000
Other Foreign Consump.	171570	172000	170400	175500	0	186000
TOTAL Dom. Consumption	175100	175230	179000	180460	0	190560
TOTAL Disappearance	176860	176930	180000	181100	0	190560
Ending Stocks	9770	9700	8330	30000	0	5000
TOTAL DISTRIBUTION	186630	186630	188330	211100	0	195560

Export Matrix: Unmanufactured Tobacco, Metric Tons

Export Trade Matrix			
Country:		Units:	
Commodity:			
Time period:			
Exports for	1997		1998
U.S.	0	U.S.	0
Others		Others	
Poland	1040	Poland	300
Lithuania	240	Lithuania	120
Turkey	210	Turkey	100
Ukraine	110	Ukraine	80
Kazakhstan	100		
Total for Others	1700		600
Others not listed	0		40
Grand Total	1700		640

Import Matrix: Unmanufactured Tobacco, Metric Tons

Import Trade Matrix			
Country:		Units:	
Commodity:			
Time period:			
Imports for	1997		1998
U.S.	1600	U.S.	4460
Others		Others	
India	40400	India	33425
Indonesia	16850	Kyrgyzstan	23335
Kyrgyzstan	14300	China	22895
Italy	12700	Moldova	13330
Greece	12250	Indonesia	12425
Uzbekistan	10550	Turkey	10240
Moldova	10500	Greece	10000
Turkey	8950	Italy	9185
Azerbaijan	8200	Canada	7885
China	8100	Azerbaijan	5700
Total for Others	142800		148420
Others not listed	40500		48020
Grand Total	184900		200900

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

Production Table						
Country:						
Commodity:	Oriental					
		1997		1998		1999
	Old	New	Old	New	Old	New
Market Year Begin						
Area Planted	700	700	650	990	0	900
Beginning Stocks	0	0	5000	5000	5000	20000
Farm Sales Weight Prod	640	640	600	520	0	600
Dry Weight Production	600	600	560	500	0	560
U.S. Leaf Imports	0	0	0	0	0	0
Other Foreign Imports	155000	155000	150000	175000	0	140000
TOTAL Imports	155000	155000	150000	175000	0	140000
TOTAL SUPPLY	155600	155600	155560	180500	5000	160560
Exports	0	0	0	0	0	0
Dom. Leaf Consumption	600	600	560	500	0	510
U.S. Leaf Dom. Consum.	0	0	0	0	0	0
Other Foreign Consump.	150000	150000	150000	160000	0	156050
TOTAL Dom. Consumption	150600	150600	150560	160500	0	156560
TOTAL Disappearance	150600	150600	150560	160500	0	156560
Ending Stocks	5000	5000	5000	20000	5000	4000
TOTAL DISTRIBUTION	155600	155600	155560	180500	5000	160560

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

PSD Table						
Country:	Russian Federation					
Commodity:	Tobacco, Mfg., Cigarettes					
		1997		1998		1999
	Old	New	Old	New	Old	New
Market Year Begin		01/1997		01/1998		01/1999
Filter Production	105000	105000	109000	110000	0	115000
Non-Filter Production	70000	70000	70000	70500	0	75000
TOTAL Production	175000	175000	179000	180500	0	190000
Imports	59000	59000	56000	65000	0	44500
TOTAL SUPPLY	234000	234000	235000	245500	0	234500
Exports	4000	4000	3500	1500	0	2500
Domestic Consumption	230000	230000	231500	244000	0	232000
TOTAL DISTRIBUTION	234000	234000	235000	245500	0	234500

Export Matrix: Cigarettes, Exports, Millions of Pieces

Export Trade Matrix			
Country:		Units:	MLN PCS
Commodity:			
Time period:			
Exports for	1997		1998
U.S.	0	U.S.	0
Others		Others	
Poland	500	Kazakhstan	50
Hungary	250	Turkmenistan	40
Tajikostan	200	Belgium	30
Georgia	170	Georgia	30
Turkmenistan	100	Kyrgyzstan	30
Kazakhstan	100	Cyprus	10
Cyprus	50	Latvia	10
Turkey	30		
Total for Others	1400		200
Others not listed	2600		1300
Grand Total	4000		1500

Import Matrix: Cigarettes, Imports, Millions of Pieces

Import Trade Matrix			
Country:		Units:	MIL PCS
Commodity:			
Time period:			
Imports for	1997		1998
U.S.	32000	U.S.	26200
Others		Others	
Germany	8000	Germany	6100
Great Britain	5000	Ukraine	5300
Kazakhstan	4000	Czech Republic	4950
Ukraine	2500	Moldova	4800
Poland	1500	Great Britain	4150
Belgium	1000	Poland	3500
Netherlands	1000	Kazakhstan	3100
Switzerland	1000	Switzerland	1900
		Bulgaria	1200
Total for Others	24000		35000
Others not listed	3000		3800
Grand Total	59000		65000

Price Tables.

Unmanufactured Tobacco

Domestic tobacco production is very small compared with consumption. Because tobacco processors rely on imported tobacco completely, prices of unmanufactured tobacco tend to be the average wholesale prices of tobacco imports (without VAT).

Prices Table					
Country:					
Commodity:					
Year:	1998				
Prices in (currency)	US dollars	per (uom)	Metric ton		
Year	1997	1998	% Change		
Jan	1477	1977	33.9%		
Feb	1633	2009	23.0%		
Mar	1736	2180	25.6%		
Apr	1707	1980	16.0%		
May	1787	2434	36.2%		
Jun	1704	2011	18.0%		
Jul	1764	2208	25.2%		
Aug	1844	2198	19.2%		
Sep	1945	2076	6.7%		
Oct	1890	2338	23.7%		
Nov	1935	2212	14.3%		
Dec	1866	1906	2.1%		

Price Table for Manufactured Tobacco

Prices given below are of wholesale prices for imported cigarettes for four reasons: One, Russia imports 20 to 30 percent of cigarettes. Two, the specifications of imported cigarettes more or less equal to those of domestically produced cigarettes. Three, there is no official information on average price of domestic cigarettes. Four, exchange rate volatility makes prices difficult to gauge for domestically produced items, especially because the internal Russian market is not transparent.

Prices Table					
Country:					
Commodity:					
Year:	1998				
Prices in (currency)	US dollars	per (uom)	1,000 pieces		
Year	1997	1998	% Change		
Jan	12.11	9.84	-18.7%		
Feb	10.02	9.71	-3.1%		
Mar	9.84	13.94	41.7%		
Apr	11.76	14.16	20.4%		
May	12.18	13.51	10.9%		
Jun	11.08	13.16	18.8%		
Jul	11.62	14.24	22.5%		
Aug	10.41	12.55	20.6%		
Sep	8.67	13.47	55.4%		
Oct	10.55	13.78	30.6%		
Nov	9.4	11.11	18.2%		
Dec	9.18	12.73	38.7%		