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## **Yugoslavia (FRY)**

### **Tobacco and Products**

## **Tobacco Industry in Yugoslavia - Update 2001**

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**Report Highlights:** Economic troubles have led to a substantial decline in raw tobacco production in Yugoslavia to roughly half of 1980 levels or 9,2000MT (MY2001 estimate). However, demand for cigarettes exceeds local supply. Finished cigarette imports of 6,700 billion pieces are forecast over the next 12 months. Total FRY cigarette consumption is estimated at 20 billion cigarettes annually. Note: All totals here apply to Serbia, Montenegro and Kosovo combined (i.e. FRY), unless otherwise stated.

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Includes PSD changes: No

Includes Trade Matrix: No

Unscheduled Report

Sofia [BU1], YI

## Overall Economic Crisis Hits Tobacco Production and Cigarette Demand

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The overall economic problems of Yugoslavia –due to 10 years of relative isolation-- have negatively affected the tobacco industry. Low cigarette prices, plus a chronic shortage of raw material imports and inputs have made cigarette production less profitable. One problem hurting both raw tobacco and cigarette production is the uneven transition of tobacco enterprises from state to private ownership. Unclear ownership laws have inhibited investment and reduced efficiencies in the tobacco industry, especially on the manufacturing side.

### Raw Tobacco Production

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Raw tobacco production is flat. The old Milosevic government called for an annual increase in tobacco production by 30 percent, but this forecast was not fulfilled due to the regional drought in MY2000. Estimated tobacco production in MY2001 is 9,200 MT or roughly at the same level as the past three years. Yugoslavia produces Burley (50 percent of total crop); Virginia (25 percent) and Oriental (25 percent). Previous government schemes focused on increasing Virginia-type tobacco production and currently exports of Virginia tobacco are prohibited. Oriental tobacco for blending is also in short supply due to smaller domestic crops. However, neighboring Balkan countries provide Yugoslavia with much of its Oriental tobacco needs.

The government has gradually increased the amount of support to the tobacco producers and manufacturers in hopes of reviving a hard currency export industry. The policies include increasing government set ceiling prices; production subsidies and favorable credits for purchases of equipment and inputs -- especially fertilizer which would boost yields.

The Yugoslav Tobacco Industry Association had forecast a MY2000 production increase to the 12,500 MT level. However, regional drought conditions reduced yields despite overall stable area planted. Only a small portion of the tobacco crop is irrigated (in South Serbia/Moravia). Yields and quality in that area were good last year. The largest MY2000 losses were found in Vojvodina in the Virginia and Burley crops. The average sized farm for Burley production is 4 hectares (HA), but for Virginia-type production, farms average 0.5 HA. Expansion in MY2001 was seen in increased area planted in the Srem region of Serbia.

### Cigarette Production

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In MY2000, Yugoslav cigarette production was estimated at 13,400 billion cigarettes which is about 65 percent of domestic use requirements. This production level is 10 percent lower when compared to 1998 (14,700 billion cigarettes). Cigarette prices in Yugoslavia are some of the lowest in Europe. Data from December 1999 shows that the cheapest local cigarette cost 9 dinars, and the most expensive cost 17 dinars or between \$.04 and \$.25 per cigarette at 1999 exchange rates. After the political changes in the country in late 2000, cigarettes prices jumped by over 30 percent. But in dollar terms, cigarette prices have fallen across the board versus last year.

Cigarette factories are forced to import a large portion of raw tobacco for blending as well as almost all other inputs. Given the low cigarette prices, profit margins in the manufacturing sector are almost zero. Factories are seeking to source the cheapest possible tobacco and inputs. Cigarette producers would like to force the government to increase prices, and to receive some support in order to make higher quality products.

#### Taxes

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Taxes on cigarettes average 40 percent of the retail price. There are several types of additional taxes such as a "check-off" tax of one diner per a pack of cigarettes which goes for subsidies for tobacco production. Relatively low taxes keep cigarette prices low. However, revenue in the budget is also reduced. Taxes on imported cigarettes are 30 percent of the total import price.

#### Cigarette Manufacturers

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There are four cigarette factories in Yugoslavia. Two of them are in Serbia (Nish and Vrania), one in Montenegro (Podgoritza), and one in Kosovo (Gniliane). The largest and most profitable manufacturing facility is in Nish with a capacity equal of the others all combined. Currently, Nish and Vrania produce cigarettes for the Serbian market with a population of about 8 million people.

Total FRY cigarette consumption is estimated at 20 billion cigarettes annually. There are plans for building a new factory in Vojvodina to increase domestic manufacturing capacity and fill this shortage. In the past, Vojvodina used to have two cigarette factories, but these were closed in the 1980s due to oversupply on the Yugoslav market.

The factory in Gniliane produces small quantities for the Kosovo market. The factory in Podgoritza used to produce about 3-4 billion cigarettes annually but currently the production is highly reduced due to the lack of export markets. The market for cigarettes inside Montenegro is small and the output of the factory in Podgoritza was increasingly targeted at Serbia. For political reasons, the Serbian market was closed to Montenegrin cigarettes from 1996 to present.

Imported cigarettes are usually sourced from former Yugoslav republics. For instance, imported Macedonian cigarettes cost between 15-20 dinars per pack and Slovenian and Croatian cigarettes cost between 25-30 dinars per pack. Western European or American cigarettes sell for 30-110 dinars/pack. As recently as 3-4 years ago, black market cigarettes accounted 50 percent of the local cigarette market. On average, the smuggling rate is estimated at 20-25 percent of total consumption. According to local importers, reductions in the Federal customs taxes reportedly could reduce smuggling.

#### Privatization

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The cigarette factory in Podgoriza was "privatized" several years ago when 46 percent of shares were sold to small share holders, mainly managers of the factory. The remaining shares are still "state" property. The new government adopted a comprehensive privatization law in mid-2001 which could allow for easier transition from public to private production of cigarettes by clarifying ownership issues..