

Opportunities for U.S. Cotton Exports to Russia

By Eric Trachtenberg and Yelena Vassilieva

The average Russian consumer needs new socks—and maybe some towels, a new T-shirt and blankets. Recovery from the 1998 economic crisis has started, and incomes have increased. Those who darned socks during hard times now want something new.

The poor condition of clothing and textile stocks in Russia indicates a high degree of pent-up demand. Demand by the military has also increased. Russians have been scooping up children's clothing, towels, stockings, pajamas and jerseys. Factories have been buying more industrial cloth, while hospitals are purchasing more gauze and medical textiles.

While delightedly hustling to keep pace with demand, Russian textile mills find they need new suppliers of cotton.

The trusted nearby source, Uzbekistan, may not be as reliable in the future, now that Soviet-era financing and supply systems are gone. Moreover, Uzbekistan's rising soil salinity and recent crossover to grain production are signs that the old ways are fading fast. Uzbek cotton production fell to 850,000 metric tons in 2000, owing to bad weather. That's down from the million tons produced the year before. It is expected to fall further in coming years.

Russia's search for new cotton suppliers has created a major opening for U.S. cotton. According to estimates by top Russian textile producers, demand for U.S. cotton should be a minimum of 15,000 tons per year. While most mills cannot afford U.S. cotton now, those that prosper during



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this growth period may be interested in buying some down the road. U.S. producers who are willing to allow payments in installments, instead of demanding cash up front, are the ones who can reach this market.

There is a precedent for U.S. sales with flexible terms. Russia purchased over \$7 million worth of U.S. cotton in 1997, through USDA's GSM-102 export credit guarantee program, which facilitates export sales by providing financial backing for payments.

Russia Takes a Cotton to Raw Imports

While Russia's demand for textiles is growing, don't expect it to result in demand for more finished-product imports. Despite a rising need for textiles, imports remained stagnant at just under 50 million

square meters in 2000. That's roughly what it's expected to be in 2001, because textiles made elsewhere will still be too costly against the weak ruble.

That is also why Russia, in spite of domestic demand, was expected to sell 550 million square meters of textiles to other countries in 2000, up 66 percent from the previous year. The main customers were the United States and the European Union, whose currencies, when stacked against the recovering ruble, make Russian-made clothing, bedding and curtains a bargain.

Unless the ruble appreciates, this flow of Russian textile exports will continue.

Textile Makers Toil Under Tolling

The Soviet-era system of bartering with Uzbekistan—cotton for farm equipment and supplies—ended in the 1990s. Its demise



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resulted in a substitute that serves the mills' needs, but limits profitability.

Under the new system, textile mills never take actual possession of the cotton, but are paid for processing it. This arrangement, known as tolling, lowers costs by allowing imports to enter free of duties and value-added taxes. Tolling also relieves Russian mills of the burden of having to buy cotton with hard currency.

There are drawbacks to tolling, however. It limits the profits a mill can gain from turning cotton into fabric. The importers most active in tolling are usually big trading companies based in Central Asia. They use the mills for processing, then sell the fabric in Russia and elsewhere, but only a few firms actually invest in the mills they rely on.

This may be one reason why industry sources say that tolling, while still accounting for about 80 percent of the total textile

GSM Program Provides U.S. Entry

Russia's demand for new cotton suppliers is already resulting in more imports. In 2000, Russia imported 295,000 metric tons of cotton, up 30 percent from the 230,000 tons 1999. Most of it came from Russia's neighbors, China and the Baltic countries.

So how can the United States break into this market?

In 1996, the United States exported \$9.3 million worth of cotton to Russia through USDA's GSM-102 export credit guarantee program while in 1997, it exported \$7 million worth. After 1998, when the

financial crisis hit, the GSM program to Russia was suspended until Russia's economic improved. Now the GSM program is open for business again in Russia and has a \$40 million credit limit. The GSM-102 program provides government guarantees for bank credits used by importers to purchase foreign goods.

In addition, USDA's Supplier Credit Guarantee Program is making its Russian debut. This \$10million program in Russia provides a partial guarantee that importers will pay for the products they buy.

production, is down from 90 percent in 1999. Recovery for Russia's mills will depend in part on relieving their chronic shortage of investment capital.

A Crystal Ball on the Future

Many Russian textile managers may wistfully recall the days of state subsidies and cheap Uzbek cotton, but the reality check is in the mail. Many of them realize that, to succeed in Russia's new economy, they must be market-oriented.

In addition, as textile production costs rise, especially in the European Union, there is an increasing interest in investing in Russian mills.

The mills still have some obstacles to overcome, however. Outmoded equipment and inefficiencies in scale of production present problems. Potential investors may be taken aback by the social obligations that Russian mills shoulder; they are often required to provide employees with clinics, kindergartens and other social services.

Still, the industry showed an 85-percent growth rate in production for 2000, turning out an impressive 1.7 billion square meters of fabric, the largest total in six years.

And the boom isn't over yet—the industry is expected to continue growing 10 percent annually.

Although production still remains far below the 6-billion-square-meter level of the mid-1980s, Russia is now producing higher quality items in response to market demand instead of the low-quality fabrics it once made for the state.

Making Your Russian Entry

About 60 percent of Russian textile production is located in the Ivanovo region, or *oblast*. In the last three years, this *oblast* has attracted many commercial traders, who now sell 40 percent of the cotton distributed in Russia. The rest comes mainly from traders based in Moscow and in supplying countries. More than half of all the cotton is imported by Rostextile, a large holding company. ■

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