

Business Fights Back Against Kremlin War on Vice

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August 22, 2012



City kiosks will lose most of their revenue and much of their popularity if they stop selling cigarettes and beer. **Sergei Porter**

With World Trade Organization membership taking effect this week, lovers of high-end imported spirits are in for a treat: Tariffs on whiskies, cognacs and other fine spirits are set to fall to make imported booze more competitive with local production.

But the tariff drops come on the heels of government crackdowns on both drinking and smoking. Those who cannot afford to indulge in Hennessy and Cuban cigars are going to be paying more for their vices as the government moves toward the understanding that there are huge health gains to be made by weaning the country off smoking and drinking.

“The tobacco epidemic is huge in Russia,” said Natalya Toropova, Coordinator of the World Health Organization’s tobacco program in Russia.

Russia is the second-biggest tobacco market in the world after China, but an even greater proportion of the population smokes.

According to the World Health Organization's Global Adults Tobacco Survey, 39 percent of Russian adults (22 percent of women and 60 percent of men) are habitual smokers, compared with 28 percent in China. Tobacco-related diseases annually take the lives of 350,000 to 400,000 people here.

The alcohol problem is even worse. The World Health Organization estimates that one in five men in the Russian Federation dies due to alcohol-related causes.

Health experts have welcomed government moves to limit advertising and make both alcohol and tobacco more expensive, while producers, distributors and vendors are already adapting to the new legal environment. But the moves have sparked acrimony about who benefits from the laws, with many smaller retailers, especially kiosk owners, accusing the government of using public health as an excuse for enriching supermarkets.

The statistics don't portray the ugly details of the country's problems with alcohol, with significant numbers of people run over, murdered, beaten up or found mysteriously dead while in police custody every weekend as a result of overindulgence.

Three fourths of the 12,000 murders in Russia in 2010 were committed under the influence of alcohol, Chairman of the Supreme Court Vyacheslav Lebedev said.

There's little better way to illustrate the extent of the problem than to surf the web on a Monday morning in search of the word "alcohol."

A single search of the news after one recent weekend produced a drunken policeman who got behind the wheel and killed a woman and two children in Volgograd with his KIA; an intoxicated man in Troitsk who was arrested for taking pot-shots from his kitchen window at passersby in his courtyard using a crossbow; a group of drunks who beat an elderly man to death after leaving a party in Irkutsk; a man detained for drunk and disorderly behavior who police claimed "committed suicide" in his cell in Khanty Mansiisk; and a drunken senior police officer in the Krasnoyarsk region who was arrested for beating up a 15-year-old while on a Saturday bender with a colleague.

The Battle Begins

The authorities' latest temperance campaign started in 2010, when the government introduced minimum pricing for vodka. The same year Moscow banned sales of strong alcohol at night, and in 2011 that policy was extended nationwide. Now there are bans on the sale of any drink stronger than 0.5 percent between 11 p.m. and 8 a.m. the next day except in restaurants and bars.

From July 1 this year, a legal loophole that formally kept beer out of the classification of alcoholic drinks was finally closed. And from Jan. 1, 2013, all beer sales will be banned from kiosks.

Meanwhile, sales of alcohol were banned in stores close to schools, markets, sports and health

facilities and other supposedly high-risk locations, and the minimum price of a half-liter bottle of vodka was jacked up from 98 to 125 rubles.

And last month President Vladimir Putin signed a decree “to create conditions to reduce the consumption of alcohol, including beer,” outlawing advertising of alcohol on the Internet and in print media. Separately, advertising of spirits has been banned everywhere — including on billboards or television — except at the point of sale.

While WTO accession will make imported premium-range spirits more affordable, and therefore competitive against Russian brands in the same segment, it is unlikely to dent the upward trend at the lower end of the market, said Maria Bovykina, distilleries sector analyst at Alfa Bank.

“[For comparison] we already have the customs union with Belarus and Kazakhstan. In Kazakhstan, the minimum price [set by the state] for a half-liter bottle of vodka is about 60 rubles (\$1.88), compared to our 125 rubles. But even so we don’t see much in flow,” she said.

As a result of WTO accession, tariffs on imported beer will be set at 0.6 euros per liter, going down to 0.018 euros by 2018. Wine tariffs will be 20 percent, reducing to 12.5 percent by 2016, and tariffs on spirits will be set at 2 euros per liter, dropping to 1.4 to 1.5 euros per liter by 2015, according to a note by trade lawyers King and Spalding.

Mandatory price hikes on commercially produced alcohol are also expected to impact the huge market in bootleg, “gray market” alcohol.

About 65 percent of the cheapest vodka available today — which costs between 100 and 140 rubles per half-liter bottle — is produced illegally, according to data from CIFFRA and Alfa Research.

State mandated hikes in minimum pricing for drinks over 28 percent alcohol mean the cheapest half-liter bottle of vodka will cost between 200 and 240 rubles in 2015, according to a forecast by CIFFRA, while the “gray” share of the lowest market segment is expected to halve to 30 percent.

Periodic Struggle

Tackling the nation’s drinking problem has been a headache for generations of Russian leaders, and was periodically cracked down on with varying success by both tsarist and Soviet governments.

The last Soviet anti-drinking drive launched by Mikhail Gorbachev in 1985 managed to boost male life expectancy by two years through drastic increases in alcoholic beverage prices, strict limits on sales hours, and prosecuting drunkenness. A 2009 study published in U.K. medical journal the *Lancet* credited the move with saving up to a million lives.

But Gorbachev’s program was also blamed for decimating national viticulture and boosting production of and dependency on sometimes-dangerous home-brews. Facing increasing unpopularity and a problematic fall in revenues from sales, enforcement was quietly eased from 1987.

The government claims the latest temperance campaign has already begun to pay off. In December last year, then-Deputy Prime Minister Viktor Zubkov claimed consumption had dropped from 18 liters to 15 liters of pure alcohol per person per year over 2011, largely because of the nighttime sales ban.

That's a success, but still leaves a large hill to climb. For comparison, when Gorbachev launched his anti-drinking campaign in 1985, consumption was at 10.5 liters per person according to official figures, though that figure does not account for illegal home brew.

The World Health Organization's benchmarks say that consumption above 8 liters per capita begins to have an adverse impact on the health of a country.

Effect on Business

No one is disputing the need for some kind of control, said Alexei Kedrin, Corporate Affairs and Government Relations director at Baltika Breweries, the country's largest beer producer.

"The restrictions on sales of alcoholic drinks during the night after 11 p.m. are an example of effective and logical restrictions to prevent alcohol abuse," he said in e-mailed comments.

But other parts of the anti-alcohol program have Baltika and many other companies breaking out in hives. Especially contentious are the advertising restrictions.

"Obviously, this will be followed by job losses. The brewing industry spends millions of rubles on ads on the Internet, and this prohibition will have extremely negative consequences for the advertising industry in Russia," Kedrin said.

"The bill is directed against business and creates obstacles for the formation of a favorable investment climate and constructive interaction between government and business in the country," he added. Businesses were not consulted, he said, and the hasty adoption of the measure meant there was no time to restructure jobs and adapt to the new conditions.

Carlsberg, which owns Baltika, has had a good year in Russia, seeing its market share rise to 37.3 percent in the second quarter from 37.0 percent in the first quarter.

Retailers say they are already feeling the pinch. Earlier this month, Magnit, Russia's largest retail chain, said it had halted alcohol sales at 255 stores since July 1 because of their proximity to schools and other restricted locations and had to temporarily suspend sales at another 144 stores while they obtained long-term leases, which are now mandatory for premises selling alcohol. But the company insisted the changes would have no significant impact on sales in 2012.

There are about 200,000 retail outlets licensed to sell alcohol in Russia, according to state regulators.

Leveling the Field

While Baltika's Kedrin would not comment on rumors that the recent legislation was pushed through by the "vodka lobby" — spirits producers have long complained that the exemption granted beer was simply unfair, despite the obvious difference in potency — he did argue that

the new rules counterintuitively make spirits more accessible than beer.

“After the increase of the beer excise up to 9 rubles per liter in 2010, the correlation between the excise on 1 liter of pure alcohol in vodka and the excise on 1 liter of pure alcohol in beer is only 1:1, which is far below the indicator of most European countries. Moreover, the cost of the beer volume equivalent to 1 liter of pure alcohol is 2.6 times higher than that of the equivalent vodka volume,” Kedrin said.

Baltika says it has been readying itself for both the advertising ban and the end of kiosk sales by shifting focus to shelf space in stores and billboards and television advertising, while declining to say how much it expects to lose in sales.

As the largest brewery in the country, with a portfolio including some of the best known brands, Baltika can expect to survive, but the same cannot be said of many retail outlets.

Kiosks, or “non-stationary trade outlets” as they are described in Russian legalese, are so dependent on alcohol and tobacco sales (some estimates say cigarettes and beer make up 70 percent of kiosk sales) that many fear the ubiquitous micro-retailers crowding the sidewalks of Russian cities could be doomed thanks to new rules on alcohol sales and a simultaneous assault on tobacco.

Second Front

The Health Ministry believes smoking accounts for another 23 percent of male deaths, meaning alcohol and tobacco combined kill almost half of all Russian men.

A draft law on tobacco developed by the Health Ministry and currently being agreed with other ministries would not only ban all tobacco advertising, but also forbid open displays of cigarettes in shops and introduce a Western-style ban on smoking in public places.

The Finance Ministry last year said it was considering hiking excise taxes to 3,000 rubles (\$94) per 1,000 cigarettes by 2015 as part of plans that would seek to add 1.9 trillion rubles (\$66.9 billion) to the federal budget over three years.

Such increases could see the price of a packet of cigarettes jump almost five times from today’s average of 30 rubles (1\$) per pack to 145 rubles by 2018, according to research by the International Tax and Investment Center.

Especially contentious is a proposed ban on tobacco sales from any retail outlet smaller than 50 square meters — a measure that kiosk owners believe is nothing more than a move to put them out of business and hand their customers to supermarkets.

“Everyone understands there need to be restrictions on alcohol and tobacco. But this is obviously an attack on one sector; they are simply handing a monopoly to the supermarkets. That is not a public health policy,” one kiosk owner told The Moscow Times at a rally organized by a kiosk owners association in May.

International health bodies have praised the bill, which has the “total support” of the World Health Organization and is on par with global standards, WHO’s Toropova said in e-mailed comments.

Big alcohol and tobacco corporations have both linked their own cause to that of the small businesses. Baltika's Kedrin says "tens of thousands" may lose jobs "in the blink of an eye," as a result of the end of beer sales at kiosks.

At a recent roundtable on the issue organized by the Russian Union of Entrepreneurs and Industrialists, several academics argued against tobacco regulation.

"There's not a single country in the world with proven experience that there is a correlation between the size of trade premises and tobacco sales," Natalya Korniyenko of the Academy of National Economy said at the July 19 event. "It is obvious that this law is intended to strengthen the position of the large supermarkets; by our estimates turnover in the small [vendor] segment will fall 30 percent under this legislation."

Others argue that a large proportion of kiosks' current clientele will turn to the black market rather than to the bigger stores. The proposed smoking ban in public places will boost corruption as bars and restaurants pay off police officers to turn a blind eye to their customers' habits.

But the tobacco law has yet to be sent to parliament, and big tobacco firms including British American Tobacco, Phillip Morris and Japan Tobacco told Bloomberg in May that they are lobbying lawmakers to find what BAT called "a mutually acceptable decision" before the ministry submits its next draft in October.

That is a danger that WHO's Toropova is aware of and plans to combat.

"The tobacco lobby is everywhere. It works to discredit public health campaigns and weaken tobacco-control policy. Still, we do hope and strongly believe that the government of the Russian Federation, as well as the Duma, will take care of this and make sure the bill gets all the support it needs and in proper time, i.e. this fall," she said.

"Similar and even stricter bills on smoke-free regulations have already come in effect in many countries which led to the decrease of smoking prevalence, growth of life expectancy and the increase of cafes and restaurants' profits," she added.

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