

# Russians Return to Vodka as Beer Prices Rise

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Brewers in Russia are streamlining operations and decreasing production volumes amid high excise duty, government overregulation and decreased consumer spending caused by the overall economic slump.

Baltika, one of Russia's four largest beer producers, said it has halted operations at two of the 10 breweries it operates in the country.

"The idea was certainly on the table as the current situation on the beer market is not getting any better," Baltika's president Isaak Sheps said on the sidelines of the Eurasian Brewers Forum held this week in Moscow.

According to the Russian statistics agency Rosstat, beer consumption last year decreased overall by 8 percent and was down another 7 percent in the first half of 2014.

"First half of this year included, the market has dropped by close to 30 percent in the last four years," Sheps said.

Baltika now has more production capacity than it needs, and over the last few years it has focused on keeping its existing facilities running rather than on building new ones, Sheps said.

A spokesman for Heineken Russia also said the shrinking market was keeping many producers from investing in new production lines. The company closed two breweries between 2009 and 2010 in Russia.

"As any beer producer would do under the circumstances we are now focused on decreasing costs," said Kirill Bolmatov, the head of corporate communications at Heineken Russia.

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On Wednesday, the Russian branch of global beer producer Anheuser-Busch InBev announced that it closed another of its breweries, the fourth one over the last three years. The reason for the shutdown, the company said, was to stay competitive amid falling beer consumption.

### **Those Excise Duties**

Brewers blame both government regulation and the high excise duties for the dip in beer sales.

Excise duties for beer were tripled in 2010, followed by an increase of another 25 percent last year.

The problem, Bolmatov said, was not the growth of excise duties per se, but the fact that the duty rate has basically leveled out with what the hard liquor producers pay, putting beer in the heavyweight league, something that should have been avoided.

Currently, the rate between excise for beer and spirits in Russia, calculated by pure alcohol, is 1 to 1.4.

By comparison, in Europe on average the excise for spirits is three times higher than for beer, and in some countries like Germany the ratio is as high as 1 to 7. This way, schnapps becomes much more expensive than beer, which encourages citizens to choose light-alcoholic drinks.

Today, the minimum price for a bottle of vodka in Russia is 220 rubles (\$5.5). Beer can be found for as low as 30-40 rubles (\$0.7-\$1) a bottle. But counterfeit vodka can cost as little as 100 rubles (\$2.5) per half-liter.

"The government has confirmed there was an increase in sales of illegal alcohol, mostly spirits, which was probably part of the reason for a decision to freeze excise duties next year," Sheps said.

As breweries are already struggling, however, this measure is unlikely to help them rebound.

## **Beer Against Vodka**

Ten years ago, when the regulation for beer in Russia was milder than for spirits, vodka, which was once the country's all-time favorite drink, was gradually being pushed out of the market.

"In the beginning of 2000s, consumption of vodka was falling every year, replaced by the consumption of beer. The alcohol-abuse-related death rate was also down at the time," Bolmatov said.

But then the situation reversed. While overall volumes of beer drunk in Russia have decreased, net alcohol consumption has stayed at about the same levels for the last two years, which means people were switching to other beverages.

"What is now happening is that growth in beer consumption has stopped, followed by a halt in the declining trend for vodka drinking. The health situation in the country has stopped improving as well," Bolmatov said.

In 2012 grocery stores and roadside kiosks were banned from selling alcohol after 11 p.m., which had an impact on so-called impulse buying, brewers said. Severe limitations on advertising, introduced the same year, also dealt a hard blow to the industry. And then macro economic trends came into play.

While last year the main factor weighing down the industry was excessive government regulation, this year the macro economy is more important, brewers said.

"People are buying less goods, a decrease in overall consumption that is affecting the industry. Also, the dramatic depreciation of the ruble is making people switch to foreign currency to protect themselves, and this money is not used in consumption," Sheps said.

## **Small Brewers Also Hit**

While the big producers can cope with the difficulties that come from increased excise duties and excessive regulation, small brewers are hit more directly.

"Before the ban on selling beer in kiosks was in place, we had a large program for summer sales in Moscow, but now all that has been canceled," said Vladimir Perlovsky, general director at Braumeister, a small brewery based in the northern city of Arkhangelsk.

Small brewers do not have the option to close down a facility to stay competitive amid falling consumption, as they usually have just one brewery. For some, the choice boils down to either selling their business or increasing prices, producers said.

"Another choice is to offer quality, although expensive beer, which has a unique taste and its share of loyal customers. Such beer is not needed in massive volumes, which is how we manage to stay afloat," Perlovsky said.

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