The Economics of Tobacco and Tobacco Taxation in Poland

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Annex

The supply side in Poland: Tobacco Farming, Manufacture, Employment, Industry Structure and Foreign Trade

Tobacco Farming

Poland’s climate is, in general, not favorable to the cultivation of tobacco. When compared to other countries Poland produces a relatively small amount of processed tobacco leaf, only 22,000 tons in 2002. By comparison, China, the global leader in processed tobacco leaf production, produced over a hundred times as much that year, at 2,394,000 tons of tobacco. In the same year, Poland ranked 37th (0.32% of total world production) in the world and 7th among European countries (4.16% of European production) that produce prepared tobacco leaves.

Poland’s raw tobacco market is regulated by the Act on the Organization of Fruit and Vegetable, Hop, Tobacco and Dried Fodder Markets, dated December 2003 and updated in March 2006 to meet European Union standards.

Tobacco can only be grown and processed in designated regions of Poland, as listed in the Regulation of the Minister of Agriculture and Rural Development. Raw tobacco is generally produced in the southern and eastern regions of Poland.

In 2005, tobacco was grown over a total area of 14,9 thousand hectares, constituting 0.18% of the total area of all agricultural land sown in the country.

As Graph A1 depicts, the tobacco crop area and harvest peaked in 1985 at 52 thousand hectares sown and 111 thousand tons of tobacco harvested. Both area and harvest have declined since then, with yields per hectare remaining relatively unchanged.

Graph A1: Tobacco crop area and harvest, Poland, 1960-2009

Source: FAOSTAT. Data was corroborated with the Polish Statistical Yearbook of Agriculture, 2010 (Rocznik Statystyczny Rolnictwa) published by the Central Statistical Office, Poland (GUS)

* Regions include: Lubelsko-Podkarpacki, Swietokrzysko-Malopolski, Kujawsko-Pomorski, Mazurski, Dolnoslaski
The political and economic transformation of the early 1990s brought with it a steady decline in tobacco crop area and harvest. The privatization process of Poland’s tobacco manufacturing plants, coupled with the entry of foreign multinationals into the domestic tobacco industry, imposed new demands on Poland’s tobacco farmers including the modernization of the raw tobacco production processes and some improvement in the quality of the raw tobacco crop harvested. Although privatization agreements obligated foreign manufacturers to maintain at least a 40% share of domestic raw tobacco in all tobacco goods produced for sale in Poland, this requirement was of short duration and expired in 2000. Due to the continued relatively low quality of the domestic tobacco crop, Poland’s multinational cigarette manufacturers, which dominate the local market, rely, to a large extent, on imported tobacco. In 2001, tobacco companies imported over 35 thousand tons of tobacco – both raw tobacco leaf and processed tobacco sheets.

Characteristics of Tobacco Farms

In the 1980s, approximately 70,000 farmers cultivated tobacco in Poland. By the late 1990s, the number of farmers engaged in tobacco growing had fallen to about 40,000. In 2004 only 17,000 tobacco farmers remained in Poland. According to the General Farm Census, these farmers worked on 16,432 farms in 2004, yielding a ratio of only about one worker per tobacco plantation.

The majority of tobacco plantations (41%) in 2004 were of 5 to 10 hectares in size. Smaller plantations (between 2 and 5 hectares) and relatively larger plantations, (10 to 20 hectares), constitute another 19% and 18% of total share, respectively. Finally, a comparatively large share (13%) of this agricultural sector is situated in small farms of less than 2 hectares.

Tobacco farmers’ incomes consist of two major components: net revenues from raw tobacco sales and agricultural subsidies. Farmers in Poland are not subject to income taxes. As a result, there is a lack of official data which would reflect the average incomes of Poland’s tobacco planters specifically.

Gross revenues from tobacco farming on 1 hectare of land may be estimated at 8101 PLN. Given existing estimates of the costs associated with tobacco cultivation the net revenue from growing tobacco from one hectare of land may be estimated at 3714 PLN. In 2005, government subsidies for raw tobacco production amounted to 5000 per ton of tobacco, or 11,500 PLN per hectare given that 1 hectare of agricultural land in Poland yields an average of 2.3 tons of raw tobacco. Adding the net revenue and government subsidy, the total income from cultivating raw tobacco from 1 hectare of land may be estimated at about 15,214 PLN in 2005. Under the current structure, the vast majority of revenue from cultivating tobacco is the direct result of the farming subsidy.

European Union agricultural policy is designed to improve the efficiency and sustainability of the agricultural sector. The EU reports “no justification for tobacco subsidies to continue to be linked to tobacco production, from a public health, as well as an economic perspective.” The EU has created the Community Tobacco Fund to help countries transition to a tobacco-neutral system of agricultural subsidies. Poland, when joining the EU, selected a single payment system and for this reason, does not participate in the Community Tobacco Fund nor has it implemented a support system for tobacco producers as called for by Part 2 of Article 13 of Council Regulation (EEC) No 2075/92.

* For comparison, until the mid-1990s, the area of tobacco crop sown was 23 thousand hectares on average and the domestic harvest measured at approximately 47 thousand tons. (PPR, 2002).

† Council Regulation (EEC) No 2075/92 of 30 June 1992 on the common organization of the market in raw tobacco. Article 13 reads: 1. A Community fund for tobacco research and information shall be set up. It shall be financed from the proceeds of a deduction not exceeding 1% from the premium at the time of payment; 2. The fund shall finance and coordinate programs of research and information to promote greater knowledge of the harmful effects of tobacco and the appropriate preventive and curative measures relevant to such effects and to orientate Community tobacco production towards the least harmful varieties and qualities.
Poland’s government does not prevent current tobacco farmers from switching to other types of crops. Substitution away from tobacco farming to other types of agricultural crops is very much feasible, particularly in light of the EU fiscal commitment to the modernization of Poland’s agriculture. This switch is likely to be easiest for those farmers who have not yet invested heavily in tobacco-specific capital (for example, tobacco drying houses) and other production processes. Some argue that given the nature of many of Poland’s tobacco farms, particularly those with small surface area (approximately 1 hectare), the identification of a crop that would prove as profitable as tobacco on small plots of land is nearly impossible. Yet, agricultural practice indicates otherwise. For example, until fairly recently, the Nowe Brzesko county near Krakow, was heavily dominated by tobacco farming. The heavy labor input as well as large capital investments required to improve the quality of the raw tobacco proved excessive relative to the estimated gain from pursuing them. As a result, this county has entirely moved to growing corn.*

Chapter V of this report presents the case for a larger role for specific taxes from the standpoint of tobacco control as—specific taxes tend to reduce the incentive for firms to keep cigarette prices low and tend to result in more predictable streams of tax revenue. Interestingly, a stronger specific tax relative to the ad valorem component of the excise tax has also found support among Poland’s federations of tobacco farmers (e.g., Polski Związek Plantatorów Tytoniu) which have moved to advocate for the equalization of excise taxes across tobacco product types.5 A strong specific tax translates into fewer cigarette price wars and less downward pressure on the price of raw tobacco. In addition, the currently strong popularity of low and mid-price segments of the tobacco market is unpopular among planters7 as it yields little benefit to those domestic plantations that were updated to meet higher-grade production processes and quality.

**Tobacco Product Manufacturing**

Cigarette manufacturing accounts for approximately 90% of total output of Poland’s tobacco manufacturing sector.† The manufacturing and marketing of smokeless tobacco products (excluding snuff) is prohibited.

In historical perspective, the production of cigarettes in Poland (Graph A2) has increased in most years since 1949; from 21.8 billion sticks to over 130 billion sticks in 2008. A decline in production between 2000 and 2004 was reversed with the relocation of production from other countries by major tobacco firms (British American Tobacco and Imperial Tobacco). Poland’s production of cigarettes has risen by over 150% between 1923 and 2006.

The share of tobacco production in the overall economy, as measured relative to total sold industrial production and total sold production, had been increasing in the early 1990’s and attained shares of 2.8% and 2.2%, respectively, in 1995. As Graph A3 reveals, beginning in 1996 and continuing through 2006, the share of tobacco production in these national output measures decreased sizably. In 2006, the value of sold cigarette production amounted to 3330 million PLN and constituted only 0.5% of sold industrial production and 0.4% of total national production sold.

**Employment within the Tobacco Industry**

Neither the Central Statistical Office nor the General Farm Census in Poland differentiates farmer employment by type of crop cultivated. Hence,
Graph A2: Cigarette production in millions of PLN, 1949-2009

Graph A3: Cigarette production in industrial and total national production, 1990-2006

measures of tobacco-related agricultural employment may only be estimated using information provided by tobacco planter trade federations. In 2004, an estimated 24,648 individuals were employed in Poland’s tobacco farming sector. This constituted roughly 0.5% of all agricultural employment in Poland in that year.

Graph A4 presents employment trends in the tobacco manufacturing sector of the industry. The number of people employed by the industry has continually declined over the last two decades. Between 1996 and 2006, employment in tobacco manufacturing fell by over one-half – from 13,300 workers in 1996 to 6,800 employees in 2005.

The reason for this decrease is likely two-fold. First, an economic slowdown in Poland’s economy occurred between 1999 and 2001, which placed downward pressure on production costs and forced reductions in the number employed in tobacco manufacturing. Second, reductions in employment were associated with the privatization of tobacco manufacturing in Poland. More specifically, in 1995, the national government issued its Strategy for the Privatization of the Tobacco Sector, and in accordance with this plan, privatized five government owned tobacco firms, a process characterized by significant downsizing and in some instances, the emergence of new production plants that required less labor. Between 1999 and 2006, there was a further decline in
employment in tobacco product manufacturing despite a rise in production and profitability of players in this industry.

As of June 2007, a total of 817 firms engaged in the wholesale trade of tobacco products. Poland’s tobacco market is dominated by four large wholesalers which control 40% of the market.* The majority of wholesalers employed less than 10 persons, and the wholesale tobacco trade sector taken together employs approximately 3,500 individuals.

In sum, the share of Poland’s labor force tobacco farming, manufacture and distribution is not significant, and has been mostly declining.

Industry Structure

Poland’s cigarette market is oligopolistic in nature and is dominated by four large international players accounting for over 98% of total sales by volume in 2009.* Market concentration increased in 2008 when British American Tobacco Polska acquired Scandinavian Tobacco and Imperial Tobacco Polska acquired Altadis Polska. Domestic cigarette producers hold only a marginal share of cigarette sales volumes in Poland. For example, the main domestic producer, Zakłady Tytoniowe w Lublinie S.A., continues to be entirely government owned and accounts for only 0.1% of cigarettes produced. Poland’s government has maintained holdings in five of the six international conglomerates operating in the country; however, the government’s share in any one of these firms did not exceed 25% in 2006.

Poland’s cigarette market is characterized by a large variety of brands – over 400 brands were counted in 2007. Brand shares fluctuate considerably in Poland. Despite each firm’s having some degree of specialization, the majority of manufacturers produce a full array of brands and are present in all price segments of Poland’s market.

Tobacco in Foreign Trade

Overall, Poland has been a net importer of raw tobacco and a net exporter of manufactured tobacco products including loose tobacco as well as cigarillos and/or cigarettes for the past two decades.

Tobacco is a small share of Poland’s foreign trade. Between 1990 and 2006, this share did not exceed 1% in either total imports or total exports.

Until 1999, Poland had a trade deficit in both tobacco trade and total trade. As the different panels of Graph A5 suggest, a turning point occurred for the tobacco trade sector around 1999 with a significant diminution of the tobacco trade deficit occurring between 1999 and 2001 and a tobacco trade surplus in years 2005-2006. This trend in tobacco trade is not replicated in total foreign trade balances which merely level-off between 2001 and 2005.

Poland’s tobacco exports are dominated by cigarettes. This is evident through their large share in the tobacco trade sector, (86% in 1992 and 83% in 2006). Beginning in 2001, a significant increase in both the import and export of manufactured loose tobacco developed. In 1992, loose tobacco constituted less than 0.5% of the export market, but it rose to approximately 12% in 2006.

Raw tobacco is the most important imported tobacco product though its share of tobacco imports has decreased over the years. At the same time, the export of cigars, cigarillos and cigarettes has significantly increased.

Overall, in 2010, Poland was a net importer of raw tobacco (trade deficit of 333 billion PLN) and a

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* Milo (13%), Konsorcjum Dystrybutorów Wyrobów Tytoniowych SA (KDWT) (10%), Polski Tytoń (9%) and Ruch (8%)
net exporter of manufactured tobacco products (trade surplus of 1343 billion PLN), including loose tobacco as well as cigarillos and/or cigarettes. In sum, tobacco is a small share of Poland’s foreign trade. Between 1990 and 2006, this share did not exceed 1% in either total imports or total exports.

Endnotes
2 Journal of Laws [Dziennik Ustaw] Nr. 209, poz. 1547
3 Poradnik Handlowca, 2002
4 Central Statistical Office Yearbooks, various years
5 Gazeta Podatnika, 2008
6 Gazeta Autorów, 2008
7 Gazeta Prawna, 2007
8 Computed from firm shares, in “Tobacco-Poland” Euromonitor International country profile, 2010