Proceedings

OUTLOOK '88

64th Agricultural Outlook Conference
U.S. Department of Agriculture
Washington, D.C. Dec. 1-3, 1987

ANNUAL AGRICULTURAL OUTLOOK CONFERENCE
United States Department of Agriculture
Washington, D.C.

Outlook '88, Session #24 For Release: Wednesday, December 2, 1987

1988 OUTLOOK FOR TOBACCO

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The second half of the 1980's decade is a transition period for the tobacco industry. Production is being held down while surplus stocks of tobacco are being used up. The industry faces continued declines in U.S. consumption of all tobacco products, heightened antismoking activity a greater number of more stringent restrictions on tobacco use, and higher taxes. Still, buoyed by legislation enacted in April 1986 that significantly changed the quota setting procedure, price support levels, and no-net-cost assessments for burley and flue-cured tobacco the outlook for tobacco growers the next few years is considerably more positive than three years ago. Supply and demand are coming into better balance, cigarette production is rising because of hiked exports, increased domestic leaf use and exports are in prospect, and increases in leaf production are anticipated for several years.

The U.S. tobacco outlook for 1987/88 is highlighted by ample, but declining supplies of leaf and reduced demand for tobacco products. Compared with a year earlier, U.S. prices are higher as the quality of this years' crop is relatively good despite drought stress in some areas. Both domestic use and exports may rise a little. U.S. production in 1987 is up about 6 percent from last years' low level. However, even with larger production lower carryin stocks reduced supplies about 6 percent to 4.6 billion pounds, with decreases in nearly every type.

The size of the 1988 crop will depend in part on USDA's decision on quotas, which must be made by December 15 for flue-cured, February 1 for burley and March 1 for other kinds. The basic quotas for flue-cured and burley may be raised, but depend on whether manufacturers' buying intentions increase. Effective quotas will likely be higher for flue-cured and lower for burley in 1988. Production of all tobacco may be up next year if yields are average. Prices in 1988 may rise because supplies of some grades of tobacco may be in short supply. Consequently, the value of the crop may increase in 1988.

U.S. Cigarette Sales Declining, Exports Up

Cigarettes are the dominant product of the tobacco industry in the United States and most other countries. Because of a 58 percent leap in cigarette exports the first 9 months of this year, output may rise to 670 billion pieces this year, about 27 billion above 1986 and the highest since 1982. However, U.S. cigarette consumption may fall about 2 percent this year, about the same decline as a year earlier. Consumption per person in the United States 18 years and older may drop by 78 cigarettes (about 4 packs of 20) from 3,274 to 3,196. This would be the lowest since 1944. During the 1970's, cigarette smokers shifted toward low-tar brands. However, there has been a reversal since 1981. Since 1981 the proportion has fallen, but it may have steadied at a little over one-half the average during the last five years.

Despite an increase in the smoking age population, total consumption of cigarettes is likely to decline again in 1988 and per capita consumption is also expected to decline. Price hikes because of increased manufacturers' costs (including profits) and tax increases are primary among reasons for the expected decline in both total and per capita consumption. The Federal excise tax has remained at 16 cents a pack of 20 since 1983, but 13 states and the District of Columbia raised excise taxes an average of 6 cents a pack in 1987. State taxes now vary from 2 cents a pack in North Carolina to 38 cents in Minnesota. Thirteen states now levy taxes of 25 cents a pack or more. The combined city and state tax is 43 cents in Chicago, Illinois. Further state tax increases are expected to occur in 1988.

Wholesale cigarette prices rose in December 1986 and again in June this year. For the last 5 years manufacturers' have raised wholesale prices 3 to 4 percent at about 6-month intervals. Retail prices have risen 6 to 8 percent a year and at a faster rate than overall consumer prices. As prices have risen, sales of generic and value-priced cigarettes (priced 15 to 35 percent lower than standard brands) have risen and now account for about a tenth of U.S. cigarette sales.

Antismoking activity, including legislation, continues to affect the industry. More than four-fifths of the states and the District of Columbia now have laws that either prohibit smoking in certain places or segregate smokers and nonsmokers. Twelve states regulate smoking in the workplace of both government and private employers and an additional six states regulate smoking in government workplaces. The General Services Administration (GSA) has implemented stringent smoking restrictions in buildings it owns or leases. Also, a large number of towns and cities have smoking restrictions. The U.S. Department of Health and Human Services and voluntary health agencies have stepped up efforts to discourage smoking. The cumulative effect of publicity and ordinances on smoking is uncertain, although it almost surely accounts for some of the downward trend in per capita consumption.

In July, the U.S. House approved a ban on smoking on commercial airline flights of 2 hours or less. Then, in late October, the Senate approved a ban on commercial airline flights of 1-1/2 hours or less for two years. The differences must be resolved by a Senate-House conference committee before it is ready for final action.

Several bills to ban advertising and promotion of tobacco products were introduced and debated in Congress this year. Furthermore, a number of bills were introduced to hike the Federal excise tax. The push to adopt measures that would dampen demand for cigarettes is expected to continue in 1988, and could even strengthen as measures are considered to generate revenues to reduce the Federal deficit.

Changes In Tobacco Per Cigarette Affect Total Use

Tobacco use in cigarettes remained relatively constant during the 1970's and in 1980 and 1981, despite the gain in cigarette output. For many years, manufacturers could economize in leaf use as they shifted to filtertip brands and used the whole leaf. Later, manufacturers began using various leaf expansion processes and in recent years have used more imported tobacco to stabilize costs. But, with production declines from 1981 to 1986, total tobacco use has decreased.

U.S. cigarette manufacturers used an estimated 1,154 million pounds of tobacco (unstemmed processing weight) in cigarettes in 1986. This was a little below 1985 even though leaf use per cigarette rose. This calendar year, with cigarette output rising perhaps about 4 percent, manufacturers may be increasing their total tobacco use.

Manufacturers used an estimated 1.79 pounds of tobacco (unstemmed processing weight) per 1,000 cigarettes produced in 1986, about 3 percent above a year earlier but considerably below the levels of 15 to 20 years ago. Domestic flue-cured accounts for about 33 percent, burley 29 percent, and Maryland 2 percent. Foreign grown was 36 percent; fifteen years earlier it was 15 percent.

Consumption of Other Tobacco Products Also Down

Large cigar consumption will likely decline about 7 percent to 2.8 billion in 1987. Production of little cigars--less than 3 pounds per 1,000--is rising after a sharp decline last year. Large cigar consumption in 1988 is expected to continue the decline that started in 1970.

Smoking tobacco consumption may have fallen to 21 million pounds in 1987, 14 percent below the previous year. Consumption of chewing tobacco has likely fallen about 4 percent. Both smoking and chewing consumption are likely to fall again in 1988.

Snuff consumption may have fallen 2 or 3 percent in 1987. Both moist and dry snuff consumption are down. Snuff consumption is likely to fall again in 1988.

Consumption of smokeless tobacco products (snuff and chewing) will likely be hurt the last third of the 1980's because of legislation enacted in 1986. The Consolidated Omnibus Budget Act of 1985 (Public Law 99-272) placed a 24-cent-a-pound Federal excise tax on snuff and an 8-cent-a-pound tax on chewing tobacco in July 1986.

In February 1986, the Comprehensive Smokeless Tobacco Health and Education Act of 1986 (P.L. 99-252) was enacted. The act requires three rotating warning labels on smokeless tobacco containers and in print advertisements, except on billboards, for the products. In addition, television and radio advertising of smokeless products has been banned.

U.S. Tobacco Crop Larger

Tobacco production is up this year because of larger acreage and higher yields. Even with slightly lower support prices, flue-cured auction prices averaged 6 cents a pound above last year. Flue-cured cash receipts from the 1987 crop were up about 7 percent. In addition to higher prices, the no-net-cost assessment charged producers was reduced from 1986's 2 1/2 cents to 2 cents this year, which boosted returns slightly.

As of November 1, the tobacco crop was forecast at 1.23 billion pounds, up 6 percent from a year earlier. Total supplies for the 1987/88 marketing year are down about 6 percent as reduced carryin more than offsets increased production.

Price support levels for flue-cured tobacco were slightly lower in 1987, burley supports remained the same, and supports for other types declined slightly. Burley auctions opened November 23 with prices averaging about 1 cent a pound above a year earlier the first week of sales. Cash receipts from the 1987 burley crop may increase 10 to 15 percent.

At the beginning of the 1987/88 marketing year, grower cooperatives held 1.02 billion pounds (farm sales weight), down about 228 million pounds or 18 percent from a year earlier. Unsold loan stocks of about 740 million pounds on October 1 were down about 32 percent from a year earlier. The reduction came about because of special ("buyout") sales authorized by 1986 tobacco legislation and lower takings of burley and flue-cured by cooperatives last season. Under buyout provisions, manufacturers agreed to buy approximately 590 million pounds (farm sales-weight) of 1976-84 flue-cured tobacco over an eight year period and about 308 million pounds of burley (farm sales-weight) over a five year period. The buyout is well ahead of schedule with about three-fifths of both the flue-cured and burley purchased within the first 2 years of the selling period.

The flue-cured auction season ended on November 12 with prices averaging $1.59 a pound, about 6 cents higher than last year. About 25 million pounds were placed under loan, 30 million fewer than a year earlier and the lowest since 1974.

Government price support is mandatory for tobacco produced under marketing quotas. Support levels for 1988 have not been set although preliminary figures indicate the flue-cured support will increase about 1 cent a pound.

Beginning in 1987, flue-cured and burley price supports are the level for the preceding year adjusted by changes in the 5-year moving average of prices (two-thirds weight) and changes in the cost of production index (one-third weight). Costs include general variable expenditures, but exclude costs of land, quota, risk, overhead, management, marketing contributions, and other costs not directly related to the production of tobacco.

Marketings from the 1987 flue-cured crop and unsold 1986 production were about 3 percent above last year's marketings. But, with a smaller carryover, flue-cured supplies for 1987/88 are about 7 percent below last season. The flue-cured effective quota was increased by about 6 percent this year. Because of excess production in 1986, 8 to 10 million pounds of 1986 crop tobacco were sold in 1987. Some growers likely have tobacco in excess of their 103 percent (amount of effective quota that can be marketed without penalty) this year.

Under the acreage-poundage program, USDA is required to announce the national marketing quota for the 1988 crop of flue-cured by December 15, 1987. The 1987 basic quota was 707 million pounds, or about 180 million pounds below prospective use. Supplies have declined each of the last 6 years, and represent about 2.7 years use. Because this season's marketings are below 1987's effective quota, the effective quota for 1988 will be higher than the basic quota.

Supplies of burley have declined since 1984, and now represent about 3 years' use. The 1987/88 supply of burley tobacco is about 4 percent below last season. Carryover stocks on October 1 were 10 percent below a year ago because of the smaller 1986 crop. This years crop increased 13 percent from last year's. Acreage is up 7 percent and yields are up 6 percent. USDA regulations allow the crop to be sold in bales, sheets, or hand-tied. Most of the crop will likely be sold in bales.

During the year ending September 30, 1987, burley disappearance totaled 567 million pounds, 1-1/2 percent below the previous year and 10 percent below 1979's record. Domestic use fell, but exports were up. Exports were up largely because of lower prices, including discounted sales of the 1983 crop. Total use may increase in 1987/88 with domestic use increasing and exports remaining at this years' record high level. Domestic use may rise because of increased cigarette production and substitution of domestic for imported burley. Lower burley auction prices, sizable dealer holdings of the 1983 burley crop, the weaker dollar, and the increasing demand for blended cigarettes worldwide may keep burley exports up.

For both flue-cured and burley tobacco, legislation requires that the national quota be based on:

1) intended purchases by cigarette manufacturers,
2) average annual exports for the 3 preceding years, and
3) the amount of tobacco needed to attain the specified reserve stock level (15 percent of the basic quota or 50 million pounds of burley or 100 million pounds of flue-cured). USDA's discretion for setting the quota is limited to not more than 103 percent or less than 97 percent of the amount determined by manufacturers' needs and exports, and the reserve stock level. If a quota reduction is required, it is limited to a maximum 6 percent reduction.

The basic flue-cured and burley quotas may be increased in 1988. The effective flue-cured quota is likely to be higher, but the effective burley quota may be lower. However, if and how much the quotas are raised depends heavily on the purchase intentions of manufacturers. Purchase intentions are the largest item in the formula for setting both flue-cured and burley quotas and they are especially large for burley. Consequently, purchase intentions are extremely important in quota determination and they depend on the industry's assessment of future stock requirements.

Among other types of tobacco, supplies of fire-cured, Maryland, dark air-cured, and cigar tobacco are all down.

Producer referendums will be held in early 1988 to determine if growers of Virginia fire-cured (type 21) and Kentucky-Tennessee fire-cured (types 22-23), and Kentucky-Tennessee dark air-cured (types 35-36) desire acreage allotments for their next three crops.

A Look Ahead

Tobacco production in the United States may rise again in 1988 and there may be an increase in production in 1989. Furthermore, hikes in production may continue for a few years into the early 1990's. The increases in production are expected because surplus stocks are being used up and current production is below disappearance. Additionally, domestic leaf use is expected to rise because of substitution of U.S. grown for imported tobacco, and exports are expected to rise because of lower prices of U.S. tobacco and increased demand for burley due to greater production of blended cigarettes throughout the world. Also, cigarette exports are rising because of strong demand for American cigarettes and the opening of markets, particularly the Far East, for U.S. cigarettes.

Hikes in production will be from the relatively low 1986 and 1987 levels. Production levels approaching the 1.8 to 2.2 billion pounds of the 1970's and early 1980's are not in the picture. Furthermore, production hikes are likely to give way to declines before the mid-1990's because falling U.S cigarette consumption will likely offset the gains cited above. State excise taxes on cigarettes will continue to increase and the Federal excise tax will almost surely be raised, perhaps substantially. Smoking restrictions and other antismoking activity will no doubt continue at the current or heightened levels. Cigarette consumption may fall an average of 2 to 3 percent a year over the next several years.