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OUTLOOK FOR TOBACCO
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The second half of the 1980's decade has been a transition period for the tobacco industry. Production has been held below pre-1986 levels while surplus stocks have been virtually depleted. The industry faces continued declines in U.S. consumption of most tobacco products, heightened antismoking activity, a greater number of more stringent restrictions on tobacco use and higher taxes. Still, buoyed by legislation enacted in 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 improved from 1986 to 1989. During this period, supply and demand came into balance, cigarette production rose in 1987 and 1988 because of hiked exports, and domestic leaf use rose.

Looking ahead two to five years, the outlook picture becomes clouded and there are signs the optimistic era may fade. Cigarette production is down in 1989 and further declines are likely in prospect because domestic consumption is falling more rapidly than added production needed for larger exports. As cigarette manufacturers annually assess their needs two to three years hence, they are likely facing smaller and smaller cigarette demand. Leaf exports may rise, but they continue to face obstacles that probably cannot offset the decline in domestic use.

The U.S. tobacco outlook for 1989/90 is highlighted by sufficient supplies overall, but shortages of some grades of tobacco have developed. Compared with a year earlier, U.S. flue-cured prices are higher and burley prices could increase. Prices are higher this year because support levels rose, the crop is of relatively good quality despite too much moisture in some areas, and supplies are tightening. After declining in 1988/89, use may rise a little in 1989/90. U.S. production in 1989 is up about 7 percent from last year. However, even with larger production lower carryin stocks reduced supplies about 2 percent to 4 billion pounds, with decreases in nearly every type.

The size of the 1990 crop will depend in part on USDA's decisions on quotas, which must be made by December 15 for flue-cured, February 1 for burley, and March 1 for other kinds. The shortening supply and continuing underproduction of burley suggests that its basic quota might be raised. For flue-cured, lower carryin reduced supplies about 2 percent and supply and demand are about in line. The flue-cured quota may not change much, although the formula requires an increase in stabilization holdings. However, the key for both flue-cured and burley is the level of manufacturers' buying intentions. Effective quotas could rise for both kinds.

Production of all tobacco may increase a little next year if yields are average. Prices in 1990 are difficult to predict, but depend heavily on the quality of the crop and whether the decline in domestic cigarette consumption moderates.

U.S. Cigarette Sales Declining, Exports Up

Cigarettes are the dominant product of the tobacco industry in the United States and most other countries. Despite an increase in exports, U.S. output may fall to 685 billion pieces this year, about 10 billion below 1988. However, U.S. cigarette consumption may fall about 3-1/2 percent this year. Consumption per person in the United States 18 years and older may drop by 160 cigarettes (8 packs of 20) from 3,096 to 2,936. This would be the lowest since 1942 and 32 percent below the 1963 peak. During the 1970's cigarette smokers shifted toward low-tar brands. However, there has been a reversal since 1981. From 1981 to 1985 the low-tar proportion (15 milligrams of tar or less) fell, but it rose for three consecutive years to about 56 percent in 1988 where it may remain this year.

Despite an increase in the smoking age population, total consumption of cigarettes is likely to decline again in 1990 and per capita consumption is also expected to decline. Price hikes because of increased manufacturers' costs and to maintain or enhance profits together with 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 15 States raised taxes an average of 8 cents a pack in 1989. State taxes now vary from 2 cents a pack in North Carolina to 40 cents a pack in Connecticut. Twelve States now levy excise taxes of 30 cents a pack or more. The combined city and state tax is 53 cents in Chicago, Illinois. Further state tax increases will occur in 1990.

Wholesale cigarette prices rose in December 1988 and again in June this year. For the last 7 years manufacturers' have raised wholesale prices 3 to 6 percent at about 6-month intervals (they rose about 10 percent during the past year). Retail prices have risen 6 to 13 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 over a tenth of U.S. cigarette sales.

Antismoking activity, including legislation, continues to affect the industry. Forty-two States either prohibit smoking in certain places or segregate smokers and nonsmokers. Fourteen States regulate smoking in the workplace of both private and government employees, and 27 States regulate smoking in government workplaces. The U.S. General Services Administration (GSA) has implemented stringent smoking restrictions in buildings it owns and 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.

A House-Senate conference committee agreed in mid-October to ban smoking on all continental U.S. airline flights and on all flights to and from Hawaii and Alaska that last six hours or less. The provision was a compromise between the Senate, which sought a permanent ban on all U.S. flights, and the House,

which preferred making permanent the current two-hour restrictions. The full House and Senate must approve the legislation before it is sent to the President for his signature.

A number of bills, besides those limiting airline smoking, have been introduced in the 101st session of Congress that could affect cigarette smoking. Most are bills that were first introduced in previous sessions. They include: 1) increasing the Federal excise tax on cigarettes; 2) banning all cigarette advertising; 3) eliminating cigarette advertising as a deductible business expense; and 4) adding another warning label to the four currently rotated on cigarette packages indicating the addictive nature of nicotine.

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. With cigarette production declines from 1981 to 1986, total tobacco use declined, but hikes in production in 1987 and 1988 boosted leaf use.

U.S. cigarette manufacturers used an estimated 1,207 million pounds of tobacco (unstemmed processing weight) in cigarettes in 1988. This was about 2 percent above 1987 as total cigarette production rose and leaf use per cigarette was up a little. This calendar year, with cigarette output declining perhaps 1 or 2 percent, manufacturers may reduce their total leaf use.

Manufacturers used an estimated 1.74 pounds of tobacco (unstemmed processing weight) per 1,000 cigarettes produced in 1988, about 1 percent above a year earlier, but considerably below the levels of 15 to 20 years ago. Domestic flue-cured accounts for about 35 percent, burley 30 percent, and Maryland 2 percent. Foreign grown was 33 percent; fifteen years earlier it was 15 percent.

Consumption of Other Products Mixed

Consumption of large cigars will likely decline about 1 percent to 2.5 billion in 1989. Production of little cigars--less than 3 pounds per 1,000--may decline after rising the last two years. Large cigar consumption in 1989 is expected to continue the decline that started in 1970.

Smoking tobacco consumption is estimated to fall to 19 million pounds in 1989, about 6 percent below the previous year. Consumption of chewing tobacco has likely fallen. Both smoking and chewing consumption are likely to fall again in 1990.

Consumption of chewing tobacco probably continues to be hurt by price hikes, publicity against smokeless products, and legislation enacted in the mid-1980's. The legislation requires rotating warning labels on product packages, a ban on radio and television advertising, and imposes a Federal excise tax on chewing tobacco.

Snuff consumption may have risen in 1989. An increase in moist consumption is more than offsetting a decline in dry snuff. Snuff consumption may rise again in 1990.

The factors listed above for chewing tobacco also apply to snuff, but after falling for two years, snuff consumption is rebounding. The hike in snuff use in 1988 and 1989 may be the result of consumers substituting snuff for smoking as the number of restrictions on smoking grows, high employment in industries where workers typically use smokeless tobacco, effective industry promotion of snuff products, and the waning of the impact of warning levels, tax hikes, and antismokeless tobacco use publicity.

World Situation

World tobacco production in 1989 is estimated at 15.9 billion pounds (farm sales weight), up 7 percent from 1988. The larger 1989 production is mainly due to hikes in the United States, Brazil, Malawi, Zimbabwe, China, and India. Production may be lower in Turkey, Mexico, Japan, and South Korea.

Of the cigarette types compared with 1988, production of flue-cured is higher in most of the major producing countries; the United States, China, India, Brazil, and Zimbabwe. Burley production is up in the United States, Brazil, Italy, and Malawi, but down in Mexico. Oriental production is down in Turkey, but up in Bulgaria, Greece, and Yugoslavia.

Production of other types is mixed. Production of dark fire-cured is about unchanged in 1989 whereas production of dark air and sun-cured and dark air-cured cigar tobacco may be up.

World cigarette production in 1988 reached 5.25 trillion, or 2-1/2 percent above a year earlier. Although consumption is stagnant or declining in the United States, Western Europe, Canada, and Japan, increased consumption in China will keep annual production changes positive for the world. In 1988, China's cigarette production was 1.53 trillion cigarettes, 6 percent above the year earlier.

Despite China's continued annual growth, stagnant consumption in the industrialized nations will likely slow the increase in cigarette output in future years.

World leaf exports during 1988 rose 7 percent to 3.3 billion pounds. Leaf exports in 1989 are expected to rise further. U.S. leaf exports were up 12 percent in 1988. The hike in exports in 1988 resulted from shipments to Egypt and Taiwan that had been delayed from 1987, rebuilding of stocks in some countries, and the better quality 1987 crop. U.S. leaf exports through September are below last year; but calendar 1989 exports may exceed those of last season. Zimbabwe also may export more tobacco in 1989 and Brazil may maintain the higher level of exports attained last year.

U.S. Tobacco Crop Larger

Tobacco production is up this year because of larger acreage; yields are lower. With higher support prices and stronger demand, flue-cured auction prices are above a year earlier. Flue-cured cash receipts from the 1989 crop

were up about 9 percent. Production costs were higher, but the no-net-cost assessment charged producers was unchanged at 1 cent (excluding the .12 cent budget deficit assessment which was slightly lower).

As of November 1, the tobacco crop was forecast at 1.47 billion pounds, up 7 percent from a year earlier. Total supplies for the 1989/90 marketing year were down about 2 percent as reduced carryin more than offset increased production.

Price supports for all kinds of tobacco are higher this season. Burley auctions opened November 20. Prices this season are averaging above a year earlier. Cash receipts from the 1989 burley crop may increase 15 to 20 percent.

As of October 1 this year, grower cooperatives held about 540 million pounds of tobacco (farm sales weight), down about 31 percent or 233 million pounds from a year earlier. Unsold loan stocks of about 310 million pounds on October 1 were down about 40 percent from a year earlier. The reduction came about because of special ("buyout") sales authorized by 1986 tobacco legislation, tightening supplies, and lower takings of burley and flue-cured by cooperatives in recent seasons.

Under buyout provisions, manufacturers agreed to buy approximately 584 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 82 percent of the flue-cured and 89 percent of the burley purchased within the first 3-1/2 years of the selling period.

The flue-cured auction season ended on November 9 with prices averaging \$1.67 a pound, about 6 cents higher than last year. About 28-1/2 million pounds were placed under loan, nearly double that of the previous season and the highest in three years. Still, loan takings were considerably below placements in the 1980-86 seasons.

Government price support is mandatory for tobacco produced under marketing quotas. Support levels for 1990 have not been set although preliminary figures indicate the flue-cured support will increase between 2 and 3 cents a pound.

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 1989 flue-cured crop and unsold 1988 production were about 5 percent above last year's marketings. But, with a smaller carryover, flue-cured supplies for 1989/90 are about 2 percent below last season. The flue-cured effective quota was increased about 11 percent this year. Because of excess production in 1988, 30 to 35 million pounds of 1988 crop tobacco were sold in 1989. Some growers have tobacco in excess of their penalty free quota (103 percent of the effective quota can be marketed without penalty) this year to carry into the 1990 season.

Under the acreage-poundage program, USDA is required to announce the national marketing quota for the 1990 crop of flue-cured tobacco by December 15, 1989. The 1989 basic quota was 890.5 million pounds, about the same as prospective use. Supplies have declined each of the last 8 years and represent about 2-1/2 years use. Because this season's marketings are below 1989's effective quota, the effective quota for 1990 will be higher than the basic quota.

Supplies of burley have declined since 1984, and now represent about 2.6 years use. The 1989/90 supply of burley tobacco is about 2 percent below last season. Carryover stocks on October 1 were 9 percent below a year ago because use exceeded 1988 production. This year's crop increased 14 percent from last year's. Acreage is up 13 percent and yields are a little higher.

Last season, disappearance of flue-cured tobacco totaled 885 million pounds, about 4 percent below the previous year. Both domestic use and exports fell. The 3-percent decline in domestic disappearance reflects smaller cigarette sales. Domestic disappearance during 1989/90 may decline a little because hiked cigarette exports probably will not offset reduced domestic cigarette consumption.

Flue-cured exports fell last year, but may rise this season because U.S. prices have been lower in recent years. Too, this year's crop is larger and is of relatively good quality.

Furthermore, despite some strengthening recently the dollar continues relatively weak and this should boost U.S. export prospects. However, U.S. exports may post only modest gains because of stagnant or declining cigarette consumption in major importing countries, reduced leaf use per cigarette, quotas and tariffs that discriminate against U.S. tobacco, and sufficient world supplies.

During the year ending September 30, 1989, burley disappearance totaled 577 million pounds, 9 percent below the previous year. Domestic use fell, but exports were up. Domestic use was down because of reduced cigarette production. Exports are up largely because of the better quality 1988 crop.

Total use of burley may increase in 1989/90. Both domestic use and exports may rise a little.

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 no more than 103 percent or less than 97 percent of the amount determined by manufacturer's needs and exports, and the reserve stock level. If a quota reduction is required, it is limited to a maximum of a 10 percent reduction.

The basic burley quota will likely be increased, but the basic flue-cured quota may not change much. The effective burley and flue-cured quotas will probably increase.

However, 1990 quota levels depend heavily on 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 assessments of future stock requirements. For flue-cured, the export component will be lower, but reserve stock levels are below minimum requirements.

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

Producer referendums will be held in early 1990 to determine if growers of Ohio cigar filler and Wisconsin cigar binder (types 42-44 and types 54-55) desire acreage allotments for their next three crops. Producers of flue-cured, burley, dark fire- and dark air-cured, and Puerto Rican cigar filler (type 46) tobacco approved marketing quotas in previous referenda. Maryland, Pennsylvania filler (type 41), and Connecticut cigar binder (types 51-52) voted against quotas in previous referenda.

A Look Ahead

Tobacco production in the United States may rise for the fourth consecutive year in 1990. But after 1990 U.S. production may begin to decline. The 1990 boost in production may bring production and use in line. However, even though cigarette exports are rising and U.S. leaf is being substituted for foreign leaf, the slide in domestic cigarette consumption may be more than offsetting and result in declining leaf use. Continued large hikes in cigarette wholesale prices, prospects for higher taxes, more and more smoking restrictions, and antismoking activities will almost surely lead to further reductions in domestic cigarette consumption. Cigarette consumption may fall an average of 2 to 3 percent a year over the next several years.