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New Opportunities for Agriculture

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Outlook '92

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OUTLOOK FOR TOBACCO

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The outlook for U.S. grown tobacco in the early 1990's has changed significantly from that of the mid-1980's. Surplus stocks have been depleted and excess supplies have given way to shortages of some kinds and grades. Leaf production is up and cigarette production has risen because of phenomenal growth in cigarette exports. Still, here in the United States the industry faces continued declines in U.S. consumption of most tobacco products, heightened antismoking activity, declining social acceptance of tobacco use, a greater number of more stringent restrictions on tobacco use, higher federal, state, and local taxes and growing competition from foreign producers.

Looking ahead the next year or two, the outlook remains bright. U.S. cigarette production in 1991 will likely exceed 700 billion units for the second consecutive year. The increased cigarette production stems from the growth in exports to the Far East, the Soviet Union, and prospects for sales to East European countries. On the other hand, domestic cigarette consumption continues to fall. Furthermore, the rate of decline has increased and may average 3 percent or more during the next several years. Leaf exports may rise, but they continue to face obstacles. In addition, it is doubtful that cigarette exports can continue to grow enough to offset declines in domestic consumption. Consequently, within the next few years, both U.S. cigarette and leaf production will likely fall.

The U.S. tobacco outlook for 1991/92 is highlighted by relatively tight domestic supplies. Compared with a year earlier, both U.S. flue-cured and burley prices are higher. The higher prices resulted from increased support prices and relatively tight domestic supplies.

After rising in 1990/91, use may decline in 1991/92. U.S. production in 1991 is down about 1 percent from last year. Together with smaller production, lower carryin stocks reduced supplies about 4 percent to 3.8 billion pounds, with decreases in nearly every type.

The size of the 1992 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 underproduction of burley in recent years suggests that the basic quota might be raised. Flue-cured supplies have fallen, so the flue-cured quota may increase. However, the key for both flue-cured and burley is the level of manufacturer's buying intentions. Effective quotas could rise for both burley and flue-cured.

Production of all tobacco will likely increase next year. Prices in 1992 are difficult to predict, but depend heavily on the quality of the crop, the size and quality of foreign crops, and the level of domestic and foreign demand for cigarettes.

U.S. Cigarette Sales Declining, Exports Up

Cigarettes are the dominant product of the tobacco industry in the United States and most other countries. With an increase in exports, U.S. output will likely exceed 700 billion units again this year (710.3 billion cigarettes were produced in 1990). However, U.S. cigarette consumption may fall about 3 percent this year. Consumption per person 18 and older may drop by 104 cigarettes (5 packs of 20) from 2,817 to 2,713. This would be the lowest consumption since 1942 and 38 percent below the 1963 peak. During the 1970's cigarette smokers shifted toward low-tar brands. However, there was a reversal after 1980. From 1981 to 1985 the low-tar proportion (15 milligrams of tar or less) fell from 60 to 52 percent of domestic sales, but it rose to 57 percent in 1990 where it may remain this year.

Despite an increase in the smoking age population, total consumption of cigarettes is likely to decline again in 1992 and per capita consumption is also likely to decline. Price hikes because of increased manufacturers' costs and their desire 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 was increased by 4 cents to 20 cents a pack on January 1, 1991. Also, eleven states and the District of Columbia increased excise taxes an average of 5 cents a pack of 20 in 1991 (North Dakota lowered its tax 1 cent). State taxes now vary from 2.5 cents a pack in Virginia to 46 cents in Hawaii. Many cities and other local governments also tax cigarettes, and four-fifths of the States now impose sales taxes on cigarettes.

Wholesale cigarette prices rose 13 percent from December 1990 to November 1991. Retail prices rose 11 percent from October 1990 to October 1991, the second largest increase in 8 years, and over 3 times the rate of increase in overall consumer prices during the same period. As prices have risen, sales of generic and value-priced cigarettes (priced 15 to 50 percent lower than standard brands) have risen and now account for over 20 percent of U.S. cigarette sales.

Antismoking activity, including legislation, continues to affect the industry. Forty-six States and the District of Columbia have laws that either prohibit smoking in certain places or segregate smokers and nonsmokers. Eighteen states regulate smoking in the workplace of both private and government employees, and thirty-five 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.

The Omnibus Budget Reconciliation Act of 1990 further increased U.S. Federal excise taxes another 4 cents to 24 cents a pack January 1, 1993. In addition, a number of bills have been introduced in the 102nd Congress that could affect cigarette smoking. Most were bills that were first introduced in previous sessions. They included: 1) increasing the Federal excise tax by substantially more than that contained in the Omnibus Budget Reconciliation Act of 1990; 2) adding additional warning labels to the four currently rotated on cigarette packages indicating the addictive nature of nicotine; and 3) requiring the disclosure of additives and ingredients in cigarettes and tobacco products.

Changes in Tobacco Per Cigarette Affects 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 leaf use fell, but production hikes in 1987 and 1988 boosted leaf use. Leaf use fell in 1989, but rose in 1990 because of an increase in cigarette production. Leaf use in 1991 may decline a little from 1990.

U.S. cigarette manufacturers used an estimated 1,236 million pounds of tobacco (unstemmed processing weight) in cigarettes in 1990. This was about 8 percent above 1989 as total cigarette production rose and leaf use per cigarette climbed. This calendar year, with cigarette production down a little, leaf use may decline.

Manufacturers used an estimated 1.74 pounds of tobacco (unstemmed processing weight) per 1,000 cigarettes produced in 1990, about 3 percent above a year earlier, but considerably below the levels of 15 to 20 years ago. Domestic flue-cured accounts for 38 percent, burley 29 percent, and Maryland 2 percent. Foreign grown was 31 percent; fifteen years earlier it was 15 percent.

Consumption of Other Products Mixed

Consumption of large cigars will likely decline about 4 percent to 2.3 billion in 1991. Production of little cigars--less than 3 pounds per thousand--may increase for the second consecutive year. Large cigar consumption in 1991 is expected to continue the decline that started in 1970. Smoking tobacco consumption continues to fall to record lows annually.

Consumption of chewing tobacco probably continues to be hurt by price hikes, publicity against smokeless products, and legislation enacted in the 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 1991. An increase in moist consumption is more than offsetting a decline in dry snuff. Snuff consumption may rise again in 1992.

The factors listed above for chewing tobacco also apply to snuff, but after falling for two years, snuff consumption has risen for four consecutive years. The hike in snuff use in 1988, 1989, 1990, and 1991 may be the result of consumers substituting snuff for smoking as the number of restrictions on smoking grows, stable employment in industries where workers typically use smokeless tobacco, effective industry promotion of snuff products, and possibly the waning of the impact of warning labels, tax hikes, and antismokeless tobacco use publicity.

World Situation

World tobacco production in 1991 is estimated at 15.7 billion pounds (farm sales-weight), up slightly from 1990. The larger 1991 production is mainly due to increases in Malawi, Zimbabwe, Argentina, South Korea, the Philippines, and Yugoslavia.

Of the cigarette types compared with 1990, production of flue-cured is higher in Zimbabwe, India, and Argentina, about unchanged in China, but lower in Brazil and the United States. Burley production is up in the United States, Mexico, Malawi, Argentina, and Italy more than enough to offset reductions in Brazil and Japan. Oriental production is down. The big drop in Turkey more than offset increases in Bulgaria and Yugoslavia.

Production of other types is mixed. Production of dark air- and sun-cured, and fire-cured is down whereas production of light air-cured and dark air cigar is up.

World cigarette production in 1990 reached 5.41 trillion units, or 2 percent above a year earlier. Although consumption is stagnant or declining in the United States, Western Europe, and Canada, increased consumption in China will keep annual production changes positive for the world. In 1990, China's cigarette production was 1.6 trillion pieces, 3 percent above the year earlier.

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

World leaf exports during 1990 rose 5 percent to 3.26 billion pounds. Leaf exports in 1991 are expected to rise further. U.S. leaf exports were up 1 percent in 1990. The slight increase in U.S. exports reflects larger shipments to the European Community. This increase more than offsets a big drop in shipments to Taiwan since inventories had been rebuilt the previous year. U.S. leaf exports through September are above last year, and calendar 1991 exports may exceed those of last season. Zimbabwe also may export more tobacco in 1991, but Brazil may reduce exports because of smaller plantings and unfavorable exchange rates.

U.S. Tobacco Crop Smaller

Tobacco production is down this year in the United States because reduced yields more than offset larger acreage. With higher support prices and relatively tight supplies, flue-cured auction prices were above a year earlier. Still, because of lower production flue-cured cash receipts from the 1991 crop were down about 1 percent. Production costs were higher, but the combined no-net-cost and marketing assessment was unchanged from the no-net-cost assessment of 1 cent a pound a year earlier.

As of November 1, the tobacco crop was forecast at 1.61 billion pounds, down 1 percent from a year earlier. Total supplies for the 1991/92 marketing year were down about 4 percent because of reduced production and carryin.

Price supports for all kinds of tobacco are higher this season. Burley auctions opened November 25. Prices this season are averaging above a year earlier. Cash receipts for the 1991 burley crop may increase 12 to 15 percent.

As of October 1 this year, grower cooperatives held about 240 million pounds of tobacco (farm sales weight), down about 44 percent or 190 million pounds from a year earlier. Unsold loan stocks of about 140 million pounds on October 1 were down by more than half 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 1986 buyout legislation, 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. By the beginning of the fifth year (July, 1990) all burley stocks had been sold. The flue-cured buyout is well ahead of schedule with about 93 percent of eligible stocks sold and over 2 years of the buyout period remaining.

The flue-cured auction season ended on November 7 with prices averaging \$1.725, about 5.2 cents above a year earlier. About 50 million pounds were placed under loan, about two-thirds those of a year earlier and the second largest in 5 years.

Government price support is mandatory for tobacco produced under marketing quotas. Support levels for 1992 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 years 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 1991 flue-cured crop and unsold 1990 production were about 4 percent below last year's marketings. Together with a smaller carryover, flue-cured supplies for 1991/92 are about 6 percent below last season. The flue-cured effective quota was 5 percent lower this year. Because of excess production in 1990, 20 to 30

million pounds of 1990 crop tobacco were sold in 1991. 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 1992 season.

Under the acreage-poundage program, USDA is required to announce the national marketing quota for the 1992 crop of flue-cured tobacco by December 15, 1991. The 1991 basic quota was 878 million pounds, below prospective use. Supplies have declined each of the last 10 years and represent about 2.1 years use. Because this season's marketings are below 1991's effective quota, the effective quota for 1991 will be higher than the basic quota.

Supplies of burley have declined since 1984, and now represent about 2.1 years use. The 1991/92 supply of burley tobacco is about 1 percent below last season.

Carryover stocks on October 1 were 10 percent below a year ago because use exceeded 1990 production. This year's crop increased 10 percent from last year. Acreage is up 14 percent, but yields are down 4 percent.

Last season, disappearance of flue-cured tobacco totaled 1.01 billion pounds, about 6 percent higher than the previous year. Both domestic use and exports rose. The 8 percent increase in domestic disappearance reflects larger cigarette output because of higher exports. Domestic disappearance during 1991/92 will likely decline from 1990/91's higher level because of stable cigarette production and prospects for greater use of foreign-grown leaf.

With tightening supplies and this year's smaller crop, exports may also decline. Also, U.S. exports continue to be hampered by stagnant or declining cigarette consumption in major importing countries, reduced leaf use per cigarette, quotas and tariffs that discriminate against U.S. tobacco, and ample world supplies.

During the year ending September 30, 1991, burley disappearance totaled 674 million pounds, 10 percent above the previous year. Both domestic use and exports were up. Domestic use was up because of increased cigarette production. Exports are up because of a good quality 1990 crop of burley and growing demand for American blended cigarettes throughout the world.

Total use of burley may decline from last season's high level in 1991/92. Both domestic use and exports may decline.

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 for burley or 100 million pounds for 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.

Both the basic burley and flue-cured quotas may be increased. Also, the effective burley and flue-cured quotas will likely rise because marketings are below the effective quota this season.

However, the 1992 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 higher but reserve stock levels are slightly above minimum requirements.

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

Producer referendums will be held in early 1992 to determine if growers of flue-cured desire acreage-poundage quotas and if growers of burley desire poundage quotas. Producer referendums will also be held in early 1992 to determine if growers of Maryland, Virginia sun-cured (type 37), Pennsylvania filler (type 41), Puerto Rico filler (type 46), and cigar binder (types 51-52) desire acreage allotments. Maryland, Pennsylvania filler (type 41), and cigar binder (types 51-52) voted against quotas in previous referenda. Growers of fire-cured (types 21-23), dark air-cured (types 35-36), and cigar filler and binder (types 41-44 and 53-55) approved marketing quotas in previous referenda.

A Look Ahead

U.S. tobacco production in 1992 will likely increase from last year which was the second highest since 1984. Excess supplies have been used up and growing cigarette exports have more than offset declining domestic consumption recently.

Continued large hikes in cigarette wholesale prices, prospects for higher taxes, more and more smoking restrictions, declining social acceptability of tobacco use in the United States, and antismoking activities will almost surely lead to further reductions in domestic cigarette consumption. Cigarette consumption may fall an average of around 3 percent a year over the next several years. In addition, cigarette export growth will likely slow. The decline in domestic cigarette consumption, a likely fall off in the rate of increase in cigarette exports, and greater substitution of foreign-produced for domestically grown tobacco will likely result in declining U.S. cigarette and leaf production by the mid-1990's.