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Outlook '93

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OUTLOOK FOR U.S. TOBACCO

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The outlook for U.S. grown tobacco during the mid-1990's is less optimistic than during the late 1980's and early 1990's. During the late 1980's and early 1990's leaf production rose and excess supplies were depleted. Also, cigarette production rose because of big increases in cigarette exports. But, cigarette export growth has slowed and domestic consumption continues to decline. In addition, cigarette manufacturers are shifting to cheaper imported leaf.

U.S. cigarette production in 1992 will likely decline for the second consecutive year after exceeding 700 billion units in 1990. The fall-off in cigarette production results from a continuing decline in domestic consumption and a leveling off of exports. Domestic consumption is falling because of periodic price increases, additional and more stringent smoking restrictions, and declining social acceptance of tobacco use. Overseas markets are experiencing similar conditions.

With lower demand for cigarettes and substitution of foreign for domestic leaf, U.S. tobacco production will likely fall in 1993. After a sharp drop from 1984 to 1986, leaf production rose 46 percent from 1986 to 1992.

The U.S. tobacco outlook for 1992/93 is highlighted by larger domestic supplies. Compared with a year earlier, flue-cured prices averaged about the same and burley prices may do likewise. The steady prices resulted from increased support prices despite marketings in excess of estimated disappearance.

After falling in 1991/92, use may stabilize in 1992/93. U.S. production in 1992 is up 1.5 percent from last year. Together with larger production, higher carryin stocks increased supplies about 2 percent to 3.9 billion pounds, with increases in both major kinds--burley and flue-cured.

The size of the 1993 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 declining use and larger supplies of both flue-cured and burley suggest that basic quotas might be lowered. However, the key for both flue-cured and burley is the level of manufacturer's buying intentions. Effective quotas will likely decline for both burley and flue-cured.

Production of all tobacco will likely decline next year. Prices in 1993 are difficult to predict, but depend heavily on the quality of the crop, support levels, the size of the carryover and current crop, and the level of domestic and foreign demand for cigarettes.

U.S. Cigarette Sales Falling, Export Growth Slowing

Cigarettes are the dominant product of the tobacco industry in the United States and most other countries. With a slowdown in export growth, U.S. output will likely decline from the 695 billion in 1991 because U.S. cigarette consumption may fall about 2 percent this year. Consumption per person 18 and over may drop by 73 cigarettes (4 packs of 20) from 2,713 to 2,640. This would be the lowest consumption since 1942 and 39 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 59 percent in 1991 where it may remain this year.

Despite an increase in the smoking age population, total consumption of cigarettes is likely to decline again in 1993 and per capita consumption is also likely to decline. The primary reasons for the expected decline are price hikes because of increased manufacturer costs and taxes, and efforts to maintain or enhance profits. The federal excise tax remained at 20 cents but will increase by 4 cents to 24 cents a pack on January 1, 1993. In 1992, six States and the District of Columbia raised excise taxes an average of 8 cents a pack of 20. State taxes now vary from 2.5 cents a pack in Virginia to 50 cents in Hawaii. Massachusetts will increase its tax to 51 cents on January 1. Many cities and other local governments also taxes cigarettes, and four-fifths of the States now impose sales taxes on cigarettes.

Wholesale cigarette prices rose 9 percent from November 1991 to July 1992. A further increase will likely occur soon. Retail prices rose 9.5 percent from October 1991 to October 1992, the smallest increase in 6 years, but still nearly 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 around 30 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. Seventeen States regulate smoking in the workplace of both private and government employees and 38 States regulate smoking in government workplaces. Also, a large number of counties and cities have some smoking restrictions. The U.S. Department of Health and Human Services and voluntary health agencies continue 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 increases U.S. Federal excise taxes another 4 cents to 24 cents a pack January 1, 1993. In addition a number of bills were introduced in the last Congress that affected cigarette smoking, but none became law. They included: 1) increasing the Federal excise tax by substantially more than already scheduled; and 2) limiting tax write-offs for advertising 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, rose in 1990 because of an increase in cigarette production, and rose again in 1991 despite a fall in cigarette production. However, leaf use in 1992 will likely decline.

U. S. cigarette manufacturers used an estimated 1,233 million pounds of tobacco (unstemmed processing weight) in cigarettes in 1991. This was slightly above 1990 despite a reduction in cigarette production because leaf use per cigarette climbed. This calendar year, with cigarette production down, leaf use may decline.

Manufacturers used an estimated 1.775 pounds of tobacco (unstemmed processing weight) per 1,000 cigarettes produced in 1991, about 2.5 percent above a year earlier, but considerably below the levels of 15 to 20 years ago. Domestic flue-cured accounts for 35 percent, burley 29 percent, and Maryland 2 percent. Foreign-grown was 34 percent; twenty years earlier it was 15 percent.

Consumption of Other Products Mixed

Consumption of large cigars will likely decline about 4 percent to 2.1 billion in 1992. Production of little cigars--less than 3 pounds per thousand--may increase for the third consecutive year. Large cigar consumption in 1992 is expected to continue the decline that started in 1970. Smoking tobacco consumption continues to fall to record lows annually.

Snuff consumption will likely increase for the fifth straight year in 1992 after declining for two consecutive years. Moist use is rising but dry use continues to decline. Chewing consumption may not change much in 1992 after rising slightly in 1991.

The recent rise in snuff and chewing consumption probably results from substitution of these products because of increased smoking restrictions. Effective industry promotion, and the possibly waning impact of warning labels, tax hikes, and negative publicity are additional factors behind the increased consumption.

U.S. Tobacco Crop Larger

Tobacco production is up this year in the United States because acreage is up. Despite higher price supports, with a relatively good quality crop, flue-cured auction prices averaged about the same as a year earlier. Combined with larger marketings, flue-cured cash receipts from the 1992 crop were up about 2 percent. Production costs were higher, but the combined no-net cost and marketing assessment was unchanged from the 1 cent a pound assessment of a year earlier.

As of November 1, the tobacco crop was forecast at 1.69 billion pounds, up 1.5 percent from a year earlier. Total supplies for the 1991/92 marketing year were up about 2 percent because of larger production and carryin.

Price supports for all kinds of tobacco are higher this season. Burley auctions opened November 23. This season's average prices may be near that of a year earlier. Cash receipts for the 1992 burley crop may increase 5 to 10 percent.

As of October 1, grower cooperatives held about 254 million pounds of tobacco (farm sales weight and excluding 1992 flue-cured receipts), up about 6 percent or 14 million pounds from a year earlier. Unsold loan stocks of 198 million pounds were up about 41 percent from a year earlier. Sales of old-crop loan stocks have slowed as inventories have declined and cigarette manufacturers have shifted to using more foreign-grown leaf. Also, special ("buyout") sales authorized by 1986 tobacco legislation have been completed--2 years ahead of schedule.

The flue-cured auction season ended on November 9 with prices averaging \$1.728, about 0.3 cent above a year earlier. About 82 million pounds were placed under loan; about 65 percent above a year earlier and the largest in 7 years.

Government price support is mandatory for tobacco produced under marketing quotas. Support levels for 1993 have not been set although preliminary figures indicate the flue-cured support will increase between 1.7 and 2.6 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 1992 flue-cured crop and unsold 1991 production were about 2 percent above last year's marketings. Together with a larger carryover, flue-cured supplies for 1992/93 are about 1 percent above last season. The flue-cured effective quota was 1 percent higher this year. Because of excess production in 1991, 50 to 55 million pounds of 1991 crop tobacco were sold in 1992. 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 1993 season.

Under the acreage-poundage program, USDA is required to announce the national marketing quota for the 1993 crop of flue-cured tobacco by December 15, 1992. The 1992 basic quota was 891 million pounds, above prospective use. After declining for 10 years, supplies are up this season and represent about 2.4 years use. Because this season's marketings are near 1992's effective quota, the effective quota for 1993 will be near the basic quota.

Supplies of burley tobacco are up this season for the first time since 1984. Supplies represent about 2.3 years use. The 1992/93 supply of burley tobacco is about 4 percent above last season.

Carryover burley stocks on October 1 were 2 percent above a year earlier because use fell below 1991 production. This year's crop increased 6 percent from last year. Acreage is up 4 percent and yields are up 2 percent.

Last season, disappearance of flue-cured tobacco totaled 875 million pounds, about 14 percent lower than the previous year. Domestic use fell but exports were about unchanged. The 23-percent decrease in domestic disappearance reflects decreased cigarette output and substitution of imported leaf and stems for domestic leaf. Despite lower cigarette production, the typical year to year variation suggests domestic disappearance during 1992/93 might rise slightly from 1991/92's low level.

With larger supplies, the weak dollar, and this year's larger crop, exports may increase a little. However, 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, 1992, burley disappearance totaled 644 million pounds, 4.5 percent below the previous year. Domestic use was down but exports were up. Domestic use was down because of reduced cigarette production and substitution of imported leaf and stems for domestic leaf. Exports are up because of a larger and relatively good quality 1991 crop of burley and growing demand for American blended cigarettes throughout the world.

Total use of burley may decline further in 1992/93. Domestic use will likely decline but exports could stay about the same.

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). 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 manufacturers' needs and exports, and the reserve stock level. Any quota reduction is limited to a maximum of 10 percent in 1993. Beginning in 1994, no limit applies.

The reserve stock adjustment may lower both the basic burley and flue-cured quotas in 1993. However, the 1993 quota levels depend heavily on purchase intentions of manufacturers which represent the industry's assessments of future stock requirements. Also, the effective burley and flue-cured quotas will likely fall because the carryover of under-marketings are expected to decline.

Among other types of tobacco, supplies of Maryland, fire-cured, and dark air-cured are down. Cigar filler and binder supplies are up.

Producer referendums will be held in early 1993 to determine if growers of Ohio cigar filler and Wisconsin cigar binder (types 42-44 and types 54-55) and Puerto Rican cigar filler (type 46) desire acreage allotments for their next three crops. Producers of flue-cured, burley, dark fire- and dark air-cured 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

U.S. tobacco production in 1993 will likely decline from this year which was the highest since 1984. Supplies of leaf have increased, cigarette production is declining, and cigarette manufacturers are substituting cheaper foreign-grown for domestic leaf.

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 will likely fall an average of between 2 and 3 percent a year over the next several years. In addition, cigarette export growth is slowing. The decline in domestic cigarette consumption, a slowdown 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 in the mid-1990's.