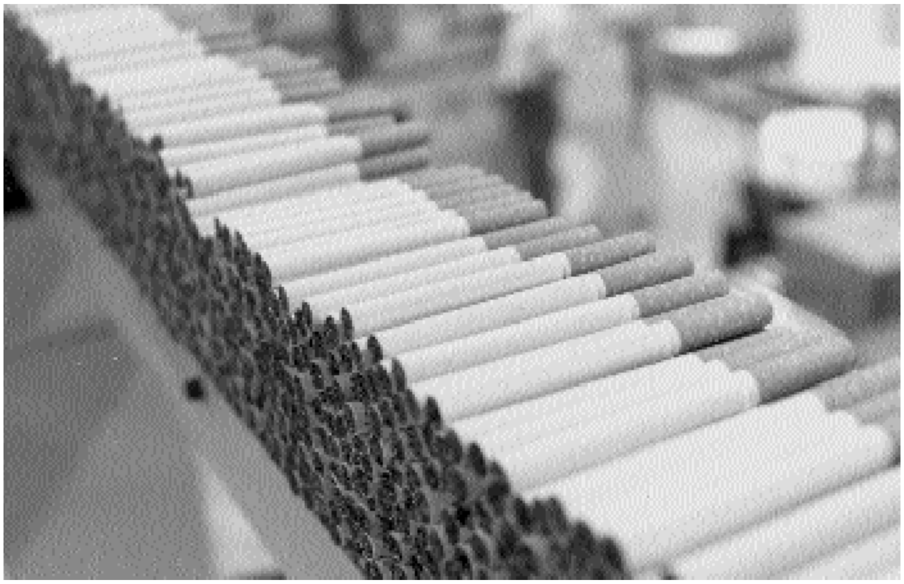
Commodity Spotlight



# Cigarette Consumption Continues to Slip

In line with a set of related downward trends over the past several years, U.S. manufacturers are making fewer cigarettes, and those they are making contain increasingly less domestic and more imported leaf. In 1999, cigarettes made in the U.S. contained 48.5 percent foreign leaf, a record high. But some downward trends appear to be easing. Compared with 1999, U.S. demand for cigarettes through July 2000 was down only 1 percent; as of September, cigarette exports were holding at about 96 percent of the year-earlier level.

In 1999, the U.S. consumed an estimated 435 billion cigarettes (2,136 per person), 15 billion fewer cigarettes than in 1998. In 2000, consumers are projected to smoke about 430 billion cigarettes (2,103 per person). Behind the continuing drop in consumption lie spiraling cigarette prices, greater awareness of health risks, and continuing restrictions on smoking areas. Two years ago, manufacturers boosted wholesale prices to cover the expenses incurred from the 1998 tobacco agreement with state attorneys general. In 2000, Federal excise taxes went up 10 cents a pack; and cigarette prices continued to go up.

In 1999, cigarette exports also continued to decline, down 50 billion cigarettes from a 1996 peak of 250 billion. But even with demand for U.S. cigarettes lower in major markets such as Europe and Japan and offshore production of U.S. brands higher, cigarette exports through September 2000 were about 96 percent of those in the same period during 1999.

Prospects for tobacco leaf exports have been looking up for 2000, as global supplies—copious in 1998 and 1999—seem to be more in line with demand. The 1997 figure of 490 million pounds (declared weight) had fallen to 420 million pounds by 1999. Still, smoking continues to decline in many countries that usually buy U.S. leaf, and with prices higher than world levels, it is difficult to pry open new markets. Some lower income countries are further put off by the absence of a U.S. Government credit program for tobacco exports (to guarantee commercial credit), which is forbidden by legislation.

Although many tobacco growers remain under financial pressure, these developments should have little adverse effect on the local economies of tobacco-producing areas. Since 1970, total personal income (in constant dollars) in the nation's 424 tobacco-growing counties has risen fairly steadily, with a cumulative increase of nearly 150 percent. Over the same period, tobacco sales have remained fairly

## Tobacco Types

Tobacco is primarily grown in six states. North Carolina ranked first and Kentucky second, followed by Tennessee, South Carolina, Georgia, and Virginia. Tobacco is also grown in Maryland, Pennsylvania, Missouri, Indiana, Ohio, Wisconsin, Alabama, Connecticut, and Massachusetts. The two top states together accounted for 65 percent of total production in 2000.

Flue-cured and burley are the major types of tobacco grown in the U.S. and accounted for 92 percent of leaf production in 2000. Flue-cured tobacco, also known as Virginia-type tobacco leaf, is grown in the southeastern U.S. and cured under heat to achieve its world-renowned golden leaf. Burley tobacco—grown in Kentucky, Tennessee, Virginia, West Virginia, Indiana, Ohio, Missouri, and North Carolina—is air-cured; the leaf is hung in a well-ventilated barn during the curing process. Maryland, fire-cured, air-cured, and cigar types complete the remaining 8 percent.

Most flue-cured and burley is used in cigarette manufacture. Maryland leaf is used solely for cigarettes. Fire-cured and air-cured are used primarily for chewing, snuff, and pipe tobacco and roll-your-own-cigarettes. Cigar leaf is divided into three types: filler, binder, and wrapper, named after the three parts of a cigar. However, most binder and filler tobaccos are now used for chewing and smoking tobacco. Cigar wrapper leaf is in a class of its own, bringing prices 10 times that of other tobacco. Nearly all wrapper—grown under protective shade—is exported to cigar-producing countries.

## Tobacco Program Sets Quotas & Price Supports

The USDA tobacco program sets marketing quotas and price supports (loan rates) to benefit tobacco growers. Assessments levied on producers and buyers cover the costs of purchasing, processing, and storing tobacco until it is sold.

Marketing quotas limit how much tobacco—both flue-cured and burley—growers are allowed to sell. Four factors combine to set the quotas: manufacturers' purchase intentions, loan stocks, exports, and the discretion of the Secretary of Agriculture.

- Manufacturers' purchase intentions are the amount of tobacco leaf companies commit to buy and are established before the marketing year begins. Companies must purchase at least 95 percent of the amount declared in their purchase intentions or pay a penalty.
- Loan stocks are the amount of tobacco held by grower cooperatives just before the marketing quotas are set.
- The figure for each year's exports is the average of the 3 previous years' exports.
- The Secretary of Agriculture has the discretion to adjust the sum of the first three factors as much as 3 percent up or down.

Once the national marketing quota for each kind of tobacco is set, the figure is divided among growers in proportion to the acreage they devote to growing that kind of tobacco. Individual growers can market up to 103 percent of their share of the quota without penalty. The tobacco a grower markets above 100 percent in 1 year, or tobacco under-marketed down to 97 percent, is carried forward to the next marketing year. The effective quota is the marketing quota adjusted by net carryover held by individual farms. It is the quantity that can actually be marketed by producers.

The USDA tobacco program bases each year's price support (loan rate) for tobacco on the price support for the preceding year. The past year's figure is adjusted based on changes in two other figures: the 5-year average of market prices (omitting high and low years) and a cost-of-production index. The Secretary of Agriculture can set the price support between 65 and 100 percent of the calculated change. Price supports vary by the grade of leaf. The overall support price for a type of leaf—for example, burley—therefore, is the weighted average of the price support for each grade of that type. AF grade of that type.

constant in nominal dollars ($2 billion to $3 billion) and have declined in real (inflation-adjusted) terms.

Growth in off-farm income has been key to offsetting declines in tobacco revenue. Most tobacco is produced in or near expanding metro areas, with nearly three-fourths of estimated tobacco receipts originating in counties in or adjacent to small metro areas. This translates into greater economic opportunities for the grower—nonfarm jobs to supplement tobacco income, rising land values, and a customer base for fruits, vegetables, and pick-your-own or other onfarm businesses, such as paid fishing or hunting. These small metro areas are near cities such as Richmond and Petersburg, Virginia; Raleigh, Durham, and Winston-Salem, North Carolina; and Lexington, Louisville, Kentucky and Knoxville, Tennessee.

### *Flue-Cured Sales Decline*

Flue-cured and burley are the major types of tobacco grown in the U.S. and accounted for 92 percent of leaf production in 2000. The 2000 flue-cured markets closed on November 2. A relatively ideal flue-cured tobacco growing season in most areas led to one of the better quality crops in recent years, with only one producing area (Type 14—Georgia and Florida) undergoing drought conditions early in the growing season.

Sales of flue-cured tobacco at auction in 2000 totaled 513.8 million pounds, representing 92 percent of the marketing quota set for the year and 82 percent of the estimated crop of 623.8 million pounds. (The quasi-governmental Flue-Cured Stabilization Corporation offers to buy flue-cured tobacco that does not receive an auction bid higher than its government-set price support level.)

Both total volume and value of flue-cured varieties slid from 1999 numbers. The drop in volume was due to the 18-percent decrease set last year for the 2000 quota. Final gross volume sold at auction (including resales) totaled 574.7 million pounds, compared with 711.7 million pounds in 1999. The average price was 179 cents per pound, compared with 173.6 cents in 1999. Flue-Cured Stabilization Corporation loan takings—tobacco which fails to make the grade support level and is purchased under the tobacco program at its price support level—were 27.2 million pounds, compared with 136.4 million pounds in 1999.

## President Establishes Tobacco Commission

On September 22, 2000, President Clinton signed an executive order establishing the "President's Commission on Improving Economic Opportunity in Communities Dependent on Tobacco Production While Protecting Public Health." The Commission will (1) advise the President on changes in the tobacco farming economy and (2) recommend ways to improve economic opportunity and development in communities that rely on tobacco production without further exposing consumers, particularly children, to the hazards associated with smoking. The Commission held two public forums in November—one in Raleigh, North Carolina, and one in Louisville, Kentucky. The group is scheduled to submit a preliminary report to the president on December 31, 2000, and a final report no later than May 2001.

Lower marketings and higher quality reduced loan takings.

The market for burley tobacco opened on November 20. Through December 13, gross sales totaled 169.7 million pounds, 223.8 million pounds less than the previous season. Prices are running higher than last season, and offerings were of higher quality. During the first 14 days of sales, the average price for burley was about 6.3 cents a pound greater than last season. Preholiday sales continued through December 14 and markets will reopen January 8. Before the holiday break, about 38 percent of expected production had been sold. Sales consisted of less fair- and low-quality leaf than last year.

### *Flue-Cured Marketing Quota Down for 2001*

On December 15, 2000, USDA announced the flue-cured marketing quota for 2001: 548.9 million pounds, 1 percent above 2000. The total national acreage allotment was set at 262,253 acres, 1 percent over 2000. However, higher onfarm carryover from 2000 will lower the effective quota (the amount of tobacco that can be marketed) to 543 million pounds or 3 percent below last season. (*See sidebar on quota.*)

Lower beginning stocks held by the industry will dampen flue-cured supplies (marketings plus beginning stocks) in 2001 by over 100 million pounds. Flue-cured supplies will be about 1.6 billion pounds.

USDA must announce the 2001 burley quota by February 1, 2001. Carryover on October 1, 2000, was 140 million pounds higher than a year earlier, as marketings exceeded use. Because this year's burley marketings are expected to fall short of the quota set for 2000, next year's quota for burley will likely be set higher. (A poor-quality burley crop in 1999 led to legislation that forgave the debt on more than 200 million pounds of burley loan stocks.)

Expected marketings in 2000 of about 420 million pounds of burley would result in burley supplies of 1.5 billion pounds, about the same as the previous year. However, with the disposition of forgiven 1999 burley loan takings uncertain, supplies could range as low as 1.26 billion pounds if the forgiven tobacco is destroyed, which is likely. **AO**

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