

World Flue-Cured Tobacco Situation

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It's good to be here today, and I appreciate the invitation. I would like to talk about the world tobacco situation. Although I now work with the Farm Service Agency, I still follow the world situation, because the global market and the global tobacco economy are extremely important to us. Some of the things that I am going to say here today you have heard before. Some of the things I am going to say are probably going to irritate some of you (but I was eligible to retire last year about this time so I am going to say them anyway). Primarily I will be talking about flue-cured tobacco, although the situation for burley is about the same.

Tobacco Production

First I would like to look at tobacco production—the countries that produce tobacco

and the types of tobacco that are produced around the world. As Figure 1 illustrates, flue-cured tobacco is by far the largest type produced. One reason is that China produces so much flue-cured tobacco. The Chinese style of cigarette is very similar to some of the old British Commonwealth all flue-cured cigarettes, and this largely explains why flue-cured makes up almost 60% of the world's tobacco production. Burley accounts for 13% along with Oriental. These two types of tobacco are basic components of the American lung cigarette in addition to flue-cured, park-cured, and sun-cured cigar smoking tobaccos.

Regarding the countries that produce tobacco (Figure 2), China accounts for well over one-third of the total world production of tobacco (40%). The other countries trail behind.

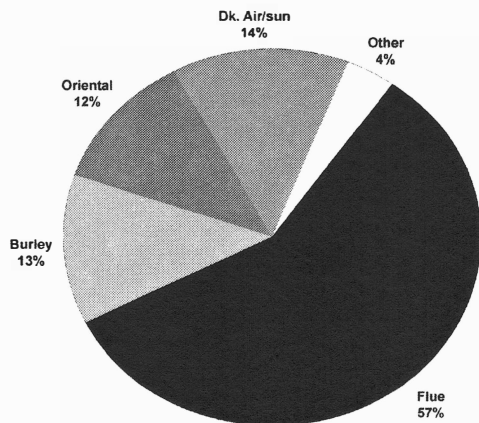


Figure 1. World Tobacco Production

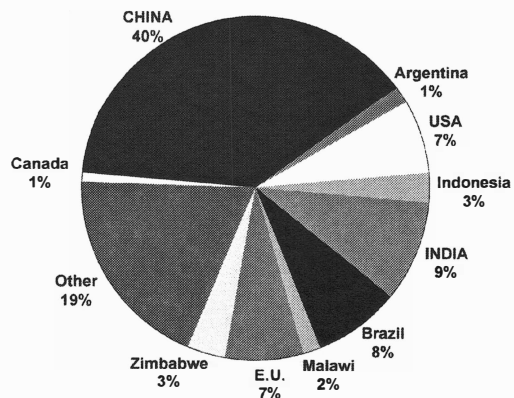


Figure 2. World Tobacco Producers, 2001

I think the important thing to consider is that the United States is just another player. Previously we were a major factor in world tobacco production, both in burley and flue-cured, but we are not anymore. Several countries, e.g., India, Brazil, the European Union, rival us and other countries have surpassed us.

Looking at the countries that trade tobacco, the breakdown by country is a bit different (see Figure 3), but the players are the same: the European Union (this includes inter-EC trade); India; the US; and Brazil, which is the big single kid on the block. Of course we recognize Brazil as our major competitor worldwide in flue-cured tobacco. Once again, the US is significant, but we are not the controlling force in the world anymore. There are a number of other countries that are involved in tobacco export.

Now turning to flue-cured tobacco, let us look at where flue-cured tobacco is produced (see Figure 4). Almost 60% of the flue-cured tobacco produced in the world comes out of China. Brazil has about 11% of the flue-cured production. The US has about 7%, Zimbabwe 5%, and it goes on down from there. The situation for flue-cured tobacco in the United States is not good. I am not saying that we should be wearing black yet. I think it is still a viable industry. I think it can be a viable industry, but

we must address some of the problems we have already heard about here this morning. India produces about 3 or 4%, but it actually took a holiday in production this past year because stocks are high and demand low. Figure 4 shows what the other major producers have produced this year, i.e., Brazil and Zimbabwe.

Zimbabwe is something of a wild card because of the political situation there now. We are really not sure what is going to happen in Zimbabwe. Producers in Zimbabwe are probably some of the best tobacco producers in the world outside of the US. They are large producers who have been producing tobacco for many generations, and their research has been second to none in the world. There is no university in this country that matches Zimbabwe's research station and tobacco scientists. But, now we are looking at Zimbabwe with a big question mark because of the political turmoil and the potential problems it will pose.

Tobacco Exports

Figure 5 illustrates countries that export flue-cured tobacco. Although China produces almost two-thirds of the world's flue-cured tobacco, it only exports about 11%, which is good news so far. Brazil is the big kid on the block. Twenty-nine percent of the flue-cured tobacco

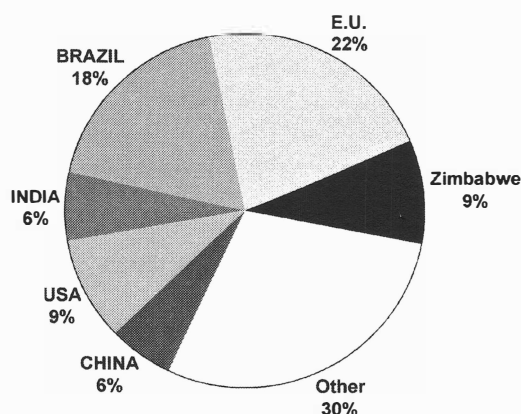


Figure 3. World Tobacco Exports, 2001

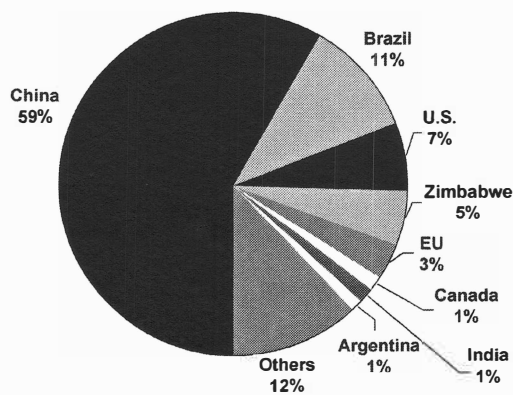


Figure 4. World Flue-Cured Tobacco Producers, 2001

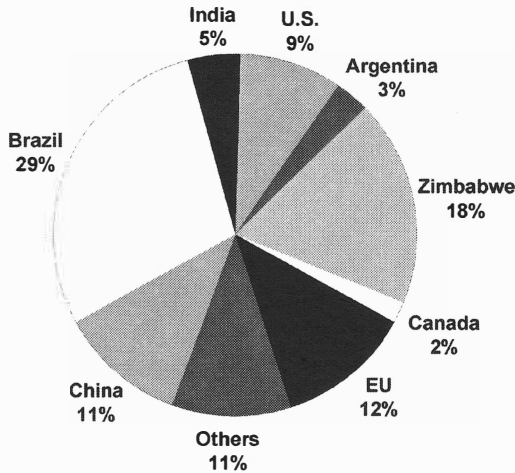


Figure 5. World Flue-Cured Tobacco Exporters, 2001

that moves in international trade comes out of Brazil. India accounts for about 5%, and the US has about 9% of the international trade. Keep in mind that 50 years ago, the US would have had close to Brazil's share now. This is what we have lost in world trade. Zimbabwe contributes about 18%—almost all of the tobacco produced in Zimbabwe is exported. Keep in mind China's figure. We have come to think of ourselves as fairly major players in the world market, but as Figure 7 below will indicate, if we compare China's exports to its production, there is truly reason for concern.

Export trends of the major tobacco trading countries appear in Figure 6. Since 1979 there has been steady growth in Brazil's export of flue-cured tobacco. Zimbabwe's growth was initially somewhat slow; then it took a spurt in growth, and now it has kind of leveled out. As I stated earlier, we do not know what is going to happen there, whether exports are going to drop or not, but certainly Zimbabwe has been a major factor, and there has been a growth industry there. Looking at China, we see a long, pretty flat line to 1990 then a series of growth

spurts and plateaus through the 1990s, and there is no reason to think that it will not take another jump. The US, in contrast, butts the trend of everybody else. Our export trend is down during this same period. Some drops are a little more significant than others, but we rarely get back to where we were when we dropped.

Earlier I mentioned that China is important to keep in mind. Figure 7 depicts China's historical trends in production, stocks, and exports. The ups and downs in their production reflect periods when stocks were too high so production was cut back. One thing China is trying to do is get tobacco production in the hands of the better growers. In other words they are trying to move tobacco production to regions like Eastern Carolina that have the climate to grow better tobacco, and to get the tobacco farmers who are not growing good tobacco out of producing it.

Note China's export line (Figure 7). China's share of world flue-cured exports is 11% while the US has 9%. China has a slightly higher share of exports, but it represents an almost minuscule portion of its total production. Of course, China is the largest consumer of tobacco in the world, which explains in part the small proportion that is exported. But, the point here is that China has an awful lot of tobacco; it has a lot of room to expand, and there is no reason to think that it will not expand. I will be quite honest with you and state that there is nobody in the world that I am aware of that can compete with China price-wise. I do not think that is true of our other competitors. I think the U.S. can compete with Brazil, with Zimbabwe, and I know we can compete with the Canadians. (Canada is quite worried that our tobacco program is going to disappear because if it does, Canada is going to be in dire straits to continue to produce flue-cured tobacco.) The potential challenge posed by the fact that China's 11% of world exports represents a small percent of its production is, I believe, a very scary situation for U.S. tobacco farmers.

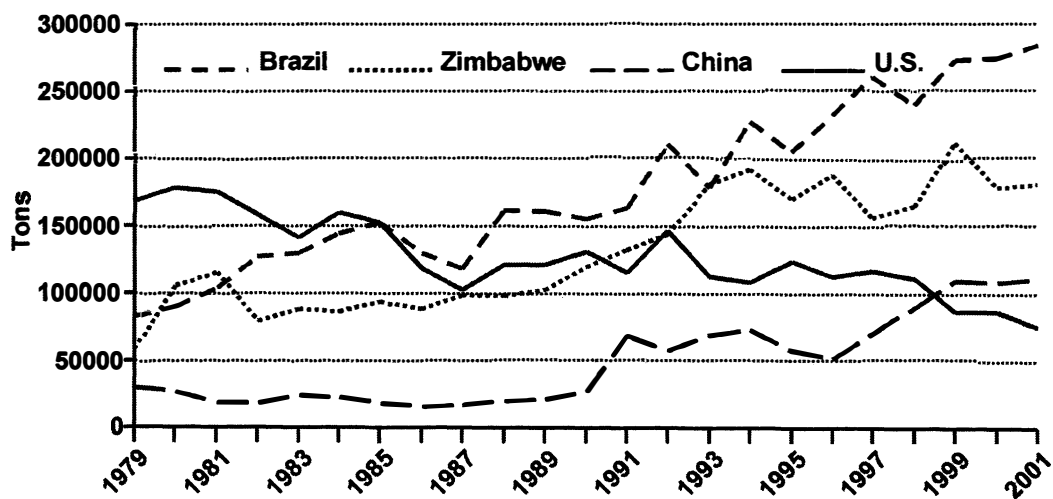


Figure 6. Flue-Cured Tobacco Export Trends

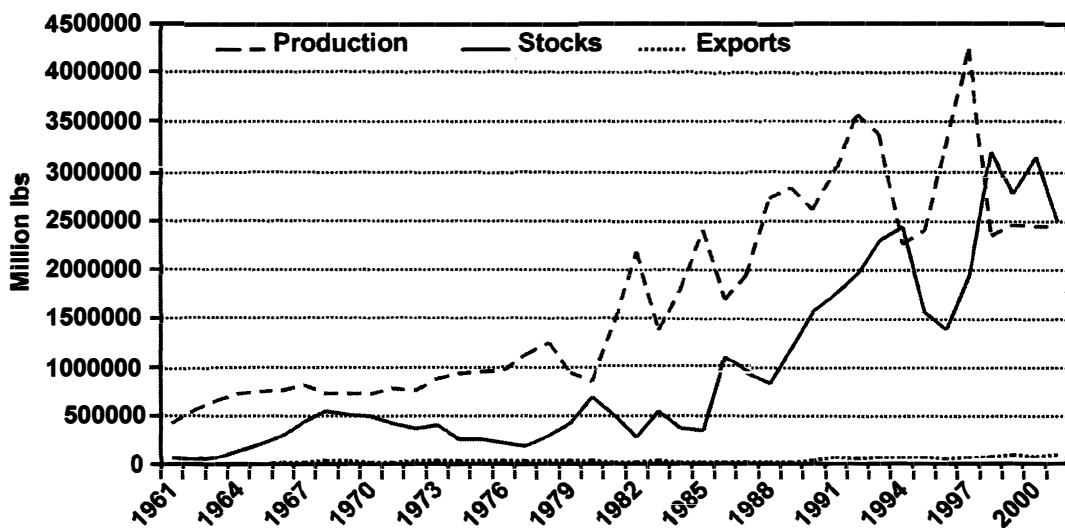


Figure 7. China: Historical Trends

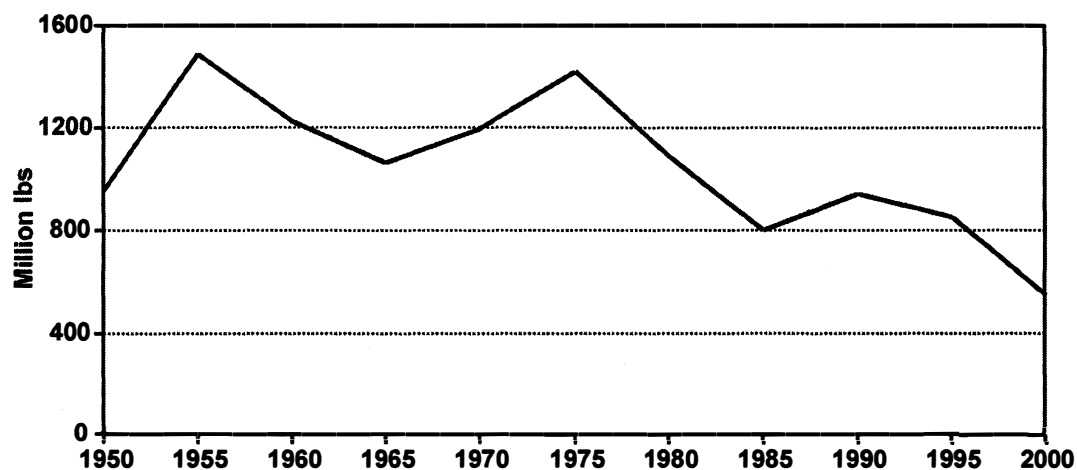


Figure 8. Flue-Cured Production in the US

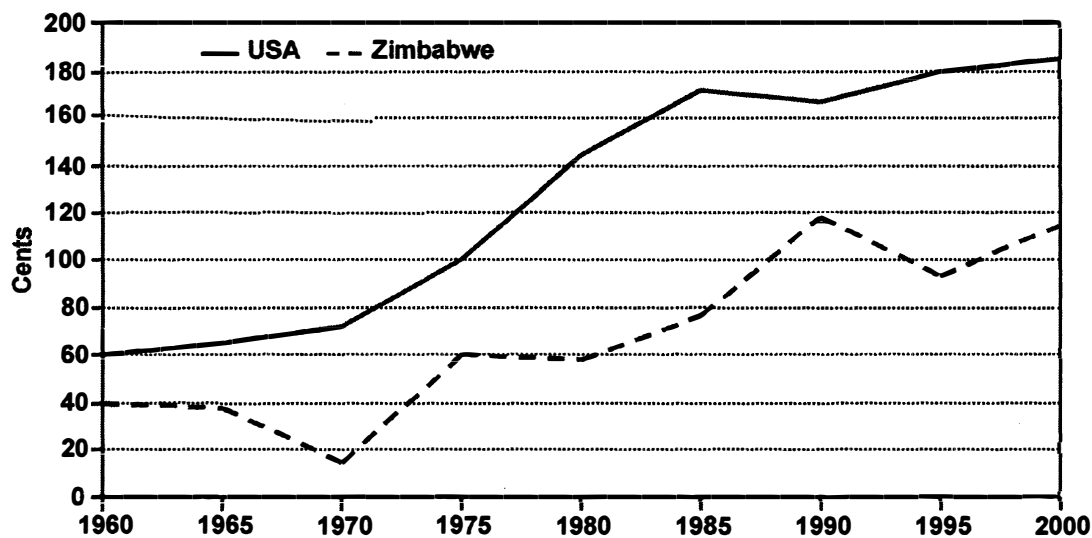


Figure 9. Flue-Cured Grower Prices

US Flue-Cured Production

Turning now to flue-cured tobacco production in the US (see Figure 8), since 1950 the trend is down. Fifty years ago the US produced 25% of the world's flue-cured tobacco. Today we are down to about 6-7%. Now I would like to look at prices. The prices that I am going to discuss are commissioner mentioned prices. Figure 9 compares US prices with Zimbabwean prices. The reason I selected these two countries is because Zimbabwe has an auction that is very similar to ours. In other words, if I were to transplant you to the sales floor in Aurora, Zimbabwe, and if you kept your eyes closed, you would think you were still in North Carolina. When you opened your eyes, however, you would realize you were not in North Carolina because it is clean. It is well lit, and you can actually find a place to eat that is almost like a three-star restaurant right on the sales floor.

I had a customer ask me once when I was visiting with the Foreign Agricultural Service if I knew what the problem with US tobacco farmers and the US tobacco industry was. I said, "No sir," but I thought to myself, "but I am sure you are about to tell me." He said, "Well they use too many pesticides." I could not argue with that. He said, "Your price support program. I pay fifty cents for every pound of tobacco I buy, and I get absolutely nothing for it." He was speaking to the commissioner, and he asked, "Why should I pay that fifty cents?" I did not have an answer for that either. Then the next thing he said was, "The thing I really dislike about your tobacco industry is that I can go to Zimbabwe and go to one place and buy all my tobacco. When I go to the US in an eight-hour day, I spend seven and a half hours in the back seat of a Buick and a half hour on the floor looking over the tobacco. And, I can't even get a hot cup coffee or find a place to go to the bathroom when I am there." I could not argue with that. He pretty well summed it up, and that was fifteen years ago.

The statement has been made that the US has the best tobacco in the world, and we do. It is consistent, it is reliable, and while we do have to worry about politics, we do not have to worry about political unrest. So companies can come here and pretty much get the tobacco they need. When we have bad years, we usually have tobacco in stock that we can fill in. Zimbabwe is comparable because it has an auction where the buyers meet the sellers. We have an auction system where the buyers meet the sellers, but look at the relative prices (see Figure 9). At a certain point the difference in the price is like comparing Fords and Chevrolets, but if all of a sudden Fords cost you a third less, some of the Chevrolets will go down too. And, that is exactly what is happening with tobacco in the tobacco world. There is a lot of loyalty among US tobacco users, but when our price gets to point where it is 75% more than the competitors', companies are going to look at that when they introduce a new brand. Are they going to use US tobacco, or are they going to go to Zimbabwe or Brazil to get tobacco? These price differences are very common, whether they be Brazilian tobacco, US tobacco, or Argentinean tobacco. We are 75% to double the prices of the other tobacco. This is the sole reason that we have fallen from 25% of the world market to about 6 or 7%.

In the mid 1980s we made some changes in our program in which we froze our price support and actually rolled the price support back. Some of the farmers here may remember that we made other changes, too. We introduced the no-net cost and so forth. A lot of people said that this was a turning point in our tobacco program. I don't know, but you will note in Figure 10a that growing prices stabilized, and actually, if you put a trend line from about 1985 to 1990, growing prices actually fell. They were still high. They were still up around 170 to 180 cents per pound, but they decline. So, our prices increased pretty steadily up to the mid 1980s, then they declined, and then they took off again about 1990.

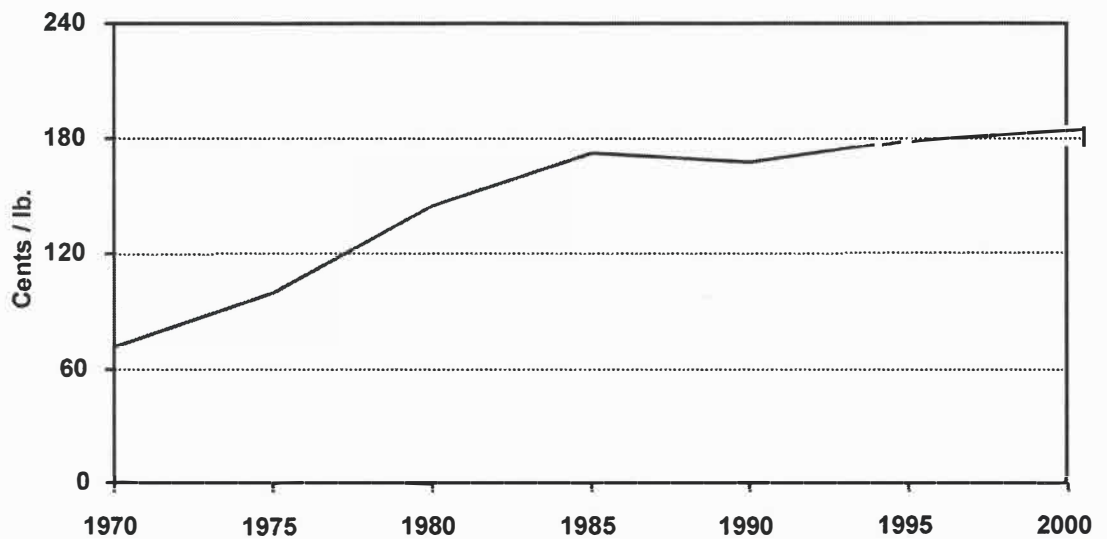


Figure 10a. US Flue-Cured Grower Prices, 1970-2000

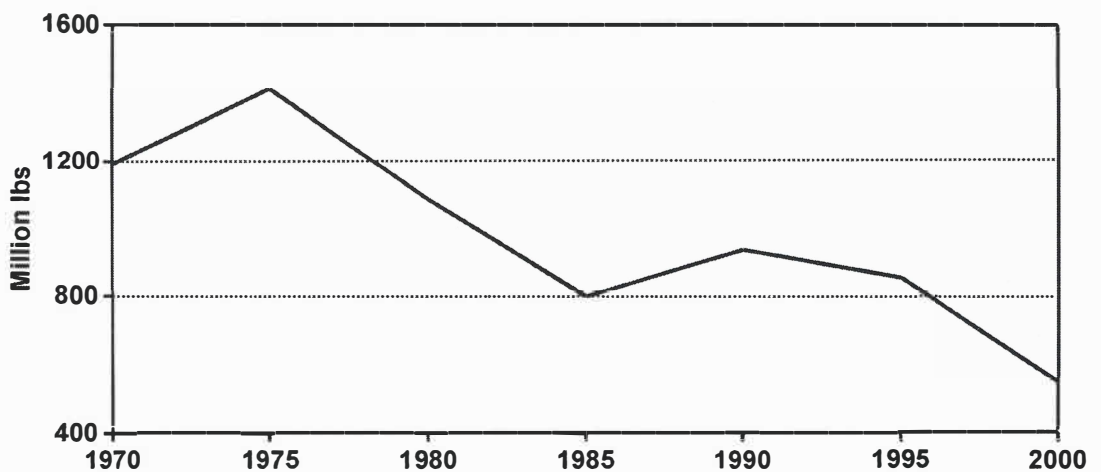


Figure 10b. US Flue-Cured Production, 1970-2000

Let's look at production in comparison. (See Figure 10b.) While prices increased through the 1970s up to the mid 1980s, production declined. Bearing in mind what happened in the mid-80s to 1990, look what happened to our production. We stabilized our prices. We rolled it back a little, and production increased. While statisticians might point out other possible correlations, the point is when we rolled our prices back a very, very small amount, confidence was restored in the market, the domestic buyers came back, and foreign buyers started looking at us again. And then our prices starting going back up, and production is falling again.

I have been working in tobacco since 1973—most of the time in the Foreign Agricultural Service. I have been all over the world to most of the major tobacco producing countries, including China and the former Soviet Union, and I am convinced that what we have in our price in this country is exactly what the man told me 15 years ago. He said, "Why should I pay 50 cents a pound for tobacco, and get absolutely nothing for that 50 cents?" This is the cost of quotas, I think.

This raises the question, of course, of what

our price would have to be to regain part of the export market. I don't know what quota rates are, and I am not sure what lease rates people are paying here now, but I know that over in Kentucky, they are as high as 80 cents. If somebody pays 80 cents for a quota and still grows tobacco and makes money on it, and the burley price is about \$1.95, we are looking at \$1.15. We will not have to come that low. I usually say between \$1.40 and \$1.50. I think that will put us back in the game.

Tobacco Consumption Trends

Figure 11 indicates another part of the problem US tobacco production is facing. During the period when the US was still hanging in the industry, the world's cigarette consumption was increasing. But, from the late 1980s and early 1990s, world cigarette consumption leveled off, and what the Foreign Agricultural Service is projecting is that growth will stop and world consumption of cigarettes will be stable. So, instead of a growing market in which we can maintain our share, we are now looking at a market that is stable. The pie is the same size, and our slice is getting smaller. I think the

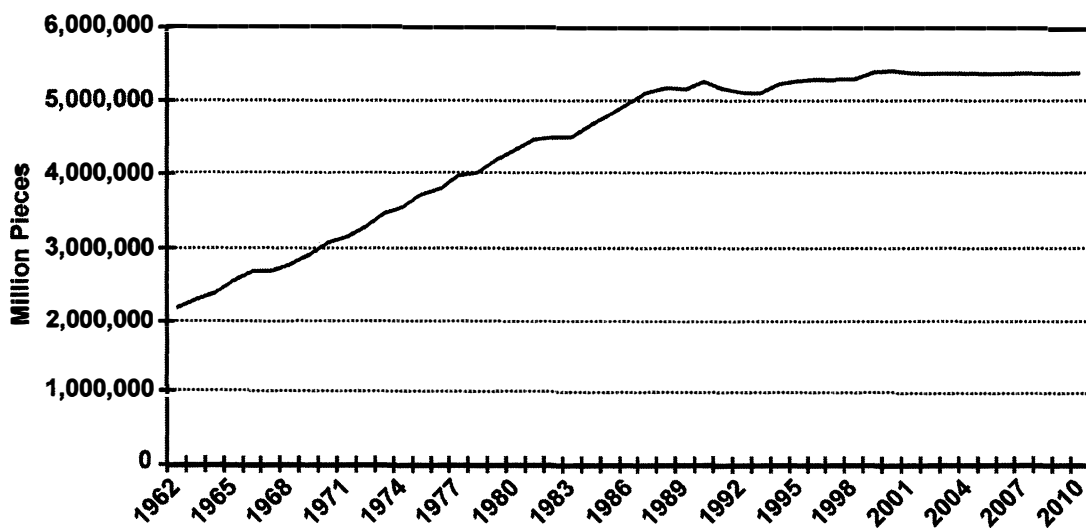


Figure 11. World Cigarette Consumption

stabilization of world cigarette consumption is a very significant development.

The US Tobacco Quota

Before concluding I would like to briefly discuss how the annual tobacco quota is set and some of the trends affecting the current quota. I get credit for setting the national quota, and some people may say that must be a tough job, but it's not really too hard. I add three numbers: 1) purchase intentions of domestic manufacturers; 2) three-year average of exports; and 3) reserve stock adjustment. We adjust stocks up by stabilization to get to the desired level, then the Secretary of Agriculture has a discretion of plus or minus 3% for these three factors, and that leads to the basic quota. It is as simple as that.

Some of the trends affecting quota levels include purchase intentions, cigarette consumption, and exports. (see Figures 12a-c.) Purchase intentions have been trending down, primarily because cigarette consumption has been trending down. Purchase intentions mirror cigarette consumption. If cigarette manufacturers' markets are declining, then the amount of tobacco they are buying will decline. Up to 1996, cigarette exports were a kind of bright spot. Our exports increased significantly, but then that peaked out for a lot of reasons that I do not have time to discuss. Cigarette exports peaked at 242 billion in 1996, but it has been down hill since. The three-year export average has also been declining, and our stocks adjustment figure has been all over the board because, as I will discuss shortly, we have a tendency to form policy in response to crisis.

Conclusions

Let me now conclude with some opinions. These are not official USDA positions, but opinions that I have come to in my career in tobacco. Foremost, I think the US is just another player. We have become too small to really control the international industry. We have lost many opportunities. During one period of po-

litical turmoil in Zimbabwe, producers struggled to get their tobacco out because there were UN sanctions on it. If you bought Zimbabwe tobacco, you were breaking UN sanctions. Who capitalized on that? The Brazilians. If you look at Brazil's growth during that period of turmoil in Zimbabwe, they are the ones that capitalized. Who is going to capitalize this time when Zimbabwe starts dropping down in production? I am not sure who will, but I think there are two possibilities. Canada may benefit, because its style of tobacco is very similar, and Brazil will capitalize again. I can tell you with certainty who is not going to capitalize unless we make some changes, and that is the US. There are opportunities that we have had, and we lost them. We need to try to straighten this out and get our markets back. I am not just talking about international markets, I am also talking about domestic markets.

I have probably used more time than I should, but I want to say a few things to prove my point. We have identified problems. There was a marketing study conducted by a group consisting of every vested interest in the tobacco industry: warehousemen, dealers, manufacturers, growers, government representatives, and folks from the land grant universities. We had a series of meetings over several months, and we identified the problems with the industry. We noted that our auction system was inefficient. We identified presentation of our product as a problem. We talked about foreign markets; about moisture; about pesticides. We talked about any number of things in our system, and the problems were identified. But, we addressed almost none of the problems that we identified.

What have we done? Instead, we have been crisis driven. Whenever we make a change it is because we've had a crisis. For example, we passed a law that US cigarette companies had to use at least 75% domestic tobacco. The World Trade Organization told us that we could not do that so we had to back away from it. But why did we pass that

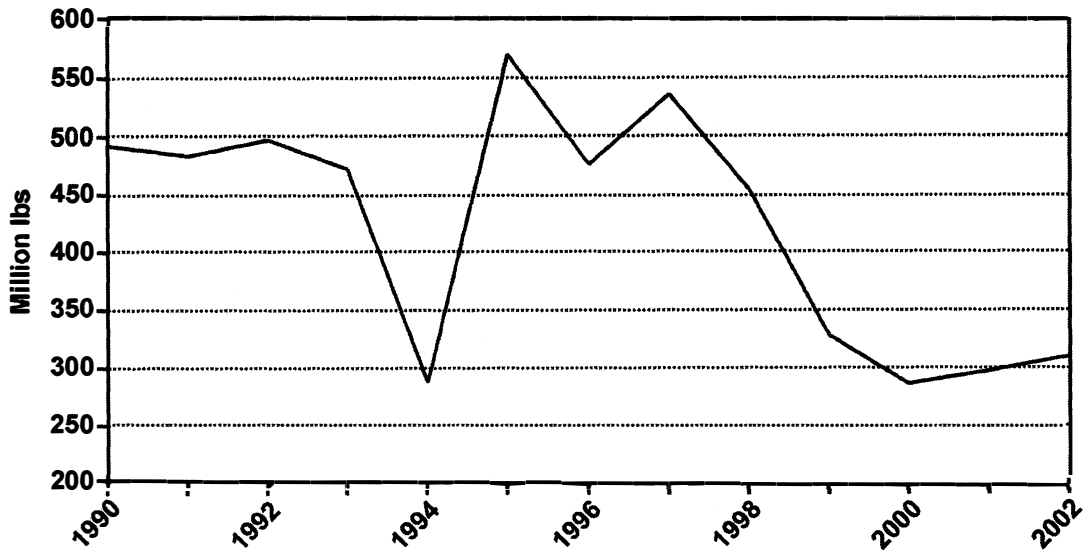


Figure 12a. Purchase Intentions

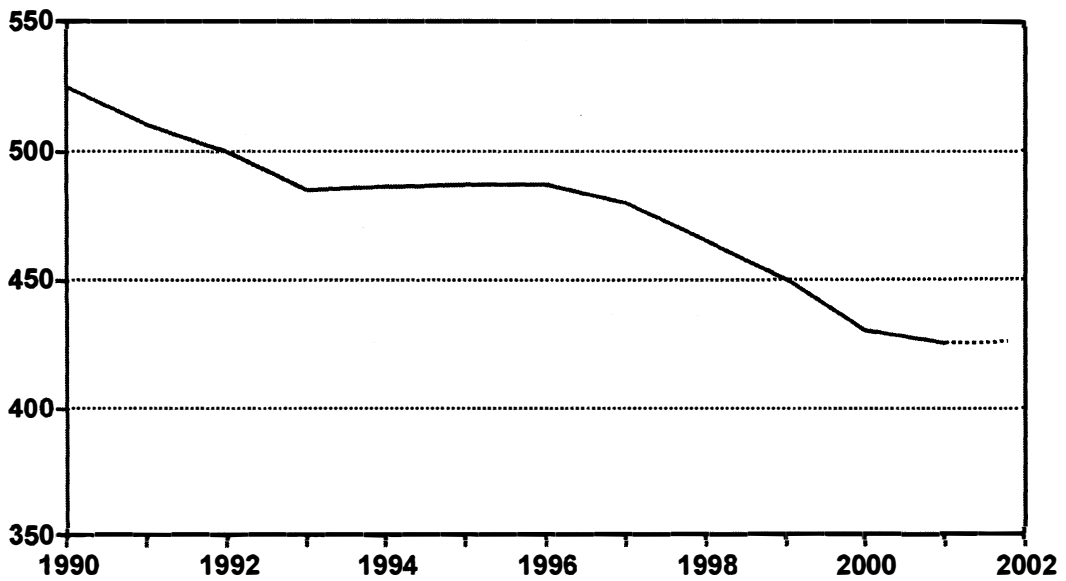


Figure 12b. US Cigarette Consumption

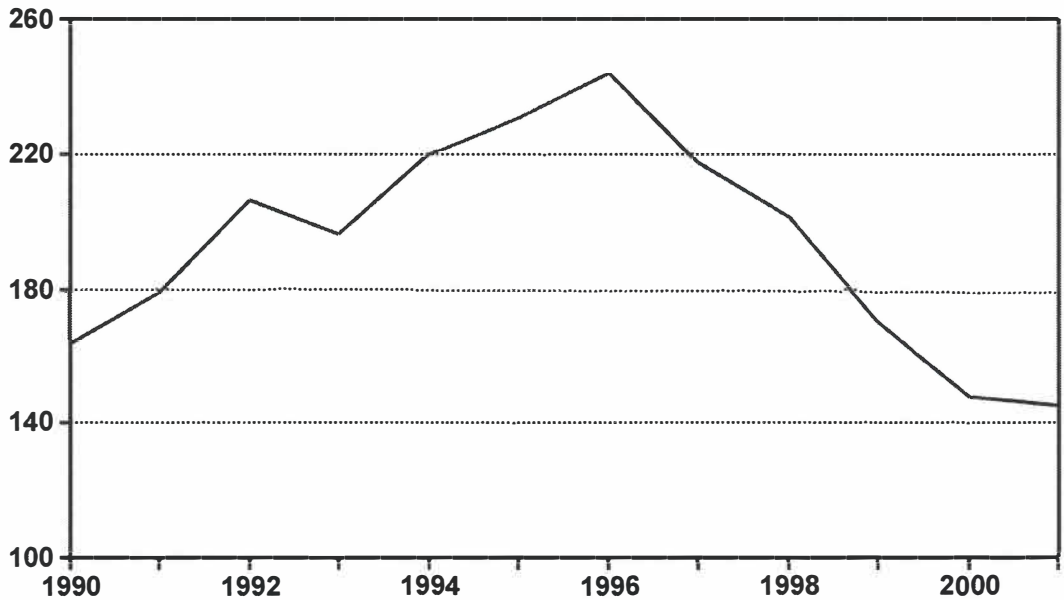


Figure 12c. US Cigarette Exports

law in the first place? Because of our imports. We were importing almost as much tobacco to meet our total demand here, and it was a crisis. So certain politicians reacted to that, and said we have to do something.

Another problem is international marketing. There is one agricultural commodity that USDA does not promote internationally. Do you know what that is? Tobacco. But you know what the one commodity that we can promote most easily is? Tobacco. What is the difference between South African corn and North Carolina corn? Not one thing, they both are the same. Now what is the difference between Zimbabwean tobacco, Brazilian tobacco and your tobacco? There is a big difference. Your tobacco is a lot higher in quality. It is product differentiation. Talk to anybody in the market—you can market something if you can differentiate it. Our tobacco is differentiated, and we can differentiate it. And, that is the difference between it becoming a corn or a soybean and it being something we can pro-

mote. If we get our price down there, our tobacco will get back into the market.

What I am saying is that we have been reactive instead of proactive to the problems in this industry. The Commissioner stood here this morning and said that we have got to stop meeting, and instead to take some action on these things. I think we know what is wrong, but the changes we make are more for political reasons than economic ones. We have got to start addressing issues in the industry because of the economics rather than the politics. There are a lot of political interests in tobacco, and there is big money being thrown into this industry now from the outside, which has muddled the picture, but we need to look at the economics of this thing. Finally, I asked the question: is it too late to reverse the situation? I will leave that up to you. I do not think it is. I think we can get back in this thing. But that is for you to answer.