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Background for 1990 Farm Legislation

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Abstract

Tobacco is grown in 21 States on about 137,000 farms. Several types and kinds are grown, but flue-cured and burley account for about 94 percent of total production. After steadily declining from 1975 to 1986, tobacco production has risen the last 3 years. Supply and demand are in balance because excess stocks have been used. After declining for several years, cigarette production rose in 1987 and 1988 because of growing exports. Legislation enacted in 1986 lowered support prices, moved loan stocks into the trade, and changed quota setting to a more market-oriented approach. Still, major problems exist. Domestic tobacco product consumption continues to decline and the United States continues to face stiff competition in world markets, even with lower prices.

Keywords: Tobacco, price supports, poundage quotas, exports, imports, costs, and returns

Foreword

Congress will soon consider new farm legislation to replace the expiring Agriculture and Food Act of 1985. Although the tobacco program is under continuing legislation, a number of problems face the tobacco industry, and amendments to modify the tobacco program may be considered in the next farm bill debate. In preparation for these deliberations, the Department of Agriculture and many groups throughout the Nation are studying preceding legislation to see what lessons can be learned that are applicable to the 1990's. This report updates Tobacco: Background For 1985 Farm Legislation (AIB-468) by Verner N. Grise and is one of a series of Economic Research Service background papers for farm legislation discussions. These reports summarize in a nontechnical form the experience with various farm programs and the key characteristics of the commodities and the farm industries which produce them. For more information, see the Additional Readings listed at the end of the text.

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Summary

Tobacco is the sixth leading field crop produced in the United States, accounting for about 3 percent of the total farm value of U.S. crops. It is grown on about 137,000 farms. During fiscal year 1988, the value of U.S. exports of unmanufactured and manufactured tobacco was \$4.1 billion, about 12 percent of the total value of agricultural exports.

The tobacco program is under continuing legislation and, unlike most commodities, it does not have to be rewritten every 4 or 5 years. But a number of legislative changes have been made since the basic marketing quota provisions of the Agricultural Adjustment Act of 1938. Legislation was enacted in 1986 that made substantial changes in the program. That law reduced flue-cured and burley price supports, changed setting of quotas to a more market-oriented approach, and provided for orderly movement of surplus stocks into trade channels.

Despite the changes that have been made in the tobacco program, several major concerns persist. Issues that affect the industry are:

- o The rationale for a tobacco program that has any government involvement.
- o If the current type of program is continued, the level of price support and the appropriateness of the current formula in determining support levels.
- o Continued high imports and sluggish export markets which dampen domestic tobacco production prospects.
- o The need for quotas at all and how to distribute quotas from nongrowers to actual growers.
- o Whether tobacco growers should be singled out from other crop growers to bear part of the costs of operating their program, whether all costs including administrative costs of program operation should be paid by growers and purchasers, and the distribution of program costs between growers and manufacturers.
- o The low-quality tobacco loan stocks and what to do about the high costs of holding these stocks and the potential for acquiring low-quality tobacco loan stocks in unfavorable growing seasons.

Worldwide tobacco consumption outside China is stagnant and new technologies are reducing the amount of tobacco needed per cigarette. Furthermore, a number of countries have increased tobacco production, many with production costs below U.S. levels. These factors are important in developing policies.

Key changes affecting the U.S. tobacco industry during the last 25 years have been:

- o The U.S. market share in world tobacco trade fell from 30 percent during 1960-64 to 14 percent by 1987. The drops for both flue-cured and burley during this period were even more pronounced: from 52 to 19 percent for flue-cured and from 57 to 24 percent for burley. With relatively high price supports keeping a floor under U.S. prices, other tobacco-producing countries sell tobacco at lower prices, in many cases less than half U.S. prices.
- o World production of tobacco rose by 61 percent between 1960-64 and 1988, while U.S. production fell 39 percent. U.S. flue-cured production was 39 percent lower. The 1988 burley crop was 26 percent lower, and the U.S. share of world production fell from four-fifths to one-third. The United States did not share in the growing cigarette consumption elsewhere in the world during the 1960's and 1970's. Much of the incentive to increase production in foreign countries was because of high U.S. support prices.
- o U.S. marketing quotas declined significantly from 1975 to 1987 (they rose in 1988 and 1989). Between 1975 and 1989 (even with increases in the 2 most recent years), the basic flue-cured quota dropped 40 percent. Burley quotas held up better because of increased exports and a slower decline in domestic use; 1989 basic quotas were only 12 percent lower than in 1975 following a 24-percent hike in quotas in 1989. The reductions occurred because of reduced cigarette consumption, lowered use of tobacco per cigarette, reduced flue-cured exports, and increases in imports of burley and flue-cured. Basic quotas for both flue-cured and burley rose in 1988 and 1989 because of used up excess supplies, increased cigarette production because of larger exports, and greater use of domestic tobacco.
- o Imports rose substantially from 1970 to 1987. U.S. cigarette manufacturers increased the share of imported flue-cured and burley tobacco in cigarettes because of lower priced imports, larger supplies of foreign-grown tobacco, new technologies that permit use of lower quality tobacco in cigarettes, and shortages of U.S. tobacco, especially burley in some years due to disease and drought. Flue-cured imports accounted for less than 1 percent of domestic disappearance of U.S. flue-cured tobacco in 1969 but rose to 28 percent in 1987. For burley, the increase was from 1 percent to 26 percent during the same period.
- o Lease and rental rates have declined because of the lowering of price supports. Still, in many cases, much of the difference between price and nonquota costs of producing tobacco is paid to the quota holder for the right to produce and sell the crop.

- o Tobacco is a high-value-per-acre crop. It is grown mostly on farms in the Southeastern United States with small total acreages of cropland. Few crops offer the same net return per acre and none offer the return above production costs, excluding land and quota, that tobacco has enjoyed during the last 50 years. U.S. tobacco production declines are forcing small farms to adjust their operations.

The tobacco program has assured a stable income to growers and generally kept supply and demand in relative balance, especially during the first three decades of its existence. However, beginning in the late 1960's and especially after the mid-1970's, many observers believed that the rate of increase in price supports needed to be slowed. Because of a concern by tobacco program supporters that legislative modifications could present opponents with an opportunity to eliminate the program altogether, no legislation was enacted until the 1981 farm act mandated that the tobacco program become essentially self-supporting. This resulted in passage of the No-Net-Cost Tobacco Act of 1982 and several other pieces of legislation over the next 4 years. However, domestic and export markets were already lost, mainly because of high U.S. prices and reduced quotas.

Economic prospects for tobacco for the remainder of the century have improved in the last 3 years. Reduced price supports, market-oriented setting of quotas and the orderly movement of surplus stocks into trade channels, and increased cigarette exports have improved prospects for U.S. tobacco. However, stagnant cigarette demand, strong foreign competition, and trade barriers continue to hold down U.S. export prospects. Furthermore, domestic U.S. cigarette consumption is likely to continue to decline. Production of U.S. tobacco is likely to decline in the 1990's following the increases of the late 1980's.