

# U.S. Tobacco Situation and Outlook

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October 13, 2014

## **Cigarette Market**

U.S. cigarette consumption declined 5.8 percent from 2012 to 2013 to 272.51 billion pieces. In 2013 the average after tax price per pack of cigarettes in the U.S. was \$5.76 with average federal, state, and local excise taxes of \$2.56 per pack. Tax revenues to federal, state and municipal governments were \$31.5 billion in 2013.

FDA regulation of U.S. tobacco products has moved at a slow but steady pace since the enactment of the Family Smoking Prevention and Tobacco Control Act of 2009. FDA has yet to rule on the inclusion of menthol in cigarettes. The menthol ruling may have significant impacts on the proposed merger of Reynolds American and Lorillard since Lorillard holds the largest share of menthol cigarettes. Menthol cigarettes make up about 30 percent of the U.S. cigarette market.

Globally, the tobacco products market was about \$783 billion in 2013. Developed country markets like the EU are in decline much like the U.S. with high taxation and regulation. In contrast the cigarette market in Southeast Asia, in particular China, is large and growing. China's tobacco products market was estimated to be \$209.7 billion in 2013 with projected growth of 17 percent in the 5 year period from 2013 to 2018. The World Health Organization's Framework Convention on Tobacco Control provides recommended regulations and taxation of tobacco products to which over 170 countries have agreed to implement. Compliance seems to vary from country to country with the European Tobacco Products Directive being among the strictest. The European Tobacco Products Directive is similar in scope and nature to FDA regulation of cigarettes in the U.S.

New technologies in nicotine delivery may erode the market for combustible cigarettes over the next decade. E-cigarettes and nicotine vaping products experienced rapid growth in recent years but are still a relatively small segment of the U.S. tobacco products market. FDA will regulate e-cigarettes as tobacco products and has issued proposed regulations. Some states have begun taxation of e-cigarettes. The health community seems divided over the potential benefit or harm from use of e-cigarettes and other vaping products. Some think e-cigarettes may aid smoking cessation. Others are concerned that e-cigarettes and vaping products may complement traditional cigarettes in that they allow smokers to continue their habit by using e-cigarettes only in places where they cannot smoke traditional cigarettes. Other non-combustible products are emerging in the cigarette market. How FDA regulates and how governments tax these emerging products will significantly impact market growth. The tobacco industry seems to be at the edge of significant technological change. While the paths of these products are uncertain, their emergence may have dramatic impacts on the traditional cigarette market, the quantity and type of tobacco needed by the industry, and leaf production practices.

## **Flue-Cured Production and Market**

With record high prices for the 2013 crop and tobacco companies encouraging farmers to increase production for 2014, U.S. flue-cured tobacco acreage rose from 228,800 acres in 2013 to an estimated 232,000 acres in 2014. Production rose to an estimated 557.4 million pounds for 2014, up from 454.3 million pounds in 2013 (table 1). The October Crop Report estimated 2014 average yield at 2,403 pounds per acre up from 1,986 in 2013. If the October forecast is correct the 2014 crop is the biggest U.S. flue-cured crop since 2001 when U.S. production was 579 million pounds.

A very wet 2013 growing season which curbed yields coupled with already short global supplies of flavor-style flue-cured tobacco led to a record high average price per pound of \$2.11 for the 2013 U.S. flue-cured market. Wet conditions in part of the Brazil flue-cured area limited attempts to increase production for the 2014 market with the 2014 crop estimated at 1.344 billion pounds, down from 1.38 billion for 2013. Zimbabwean growers increased production for the 2014 market 29 percent to 474 million pounds, up from 367 million pounds for 2013. Average price per pound for the 2014 Zimbabwe crop was US\$1.44 down 14 percent from US\$1.67 in 2013. With increased production, prices for the 2014 U.S. crop are down and may average below \$2.00 per pound.

**Table 1: U.S. Flue-Cured Tobacco Production, 2004 to 2014, in million pounds.**

	Florida	Georgia	North Carolina	South Carolina	Virginia	U.S. Total	Average Price/lb
2004	9.8	46.7	344	63.4	57.6	521.5	1.845
2005	5.5	27.8	273.9	39.9	33.7	380.8	1.474
2006	2.9	30.1	324.0	48.3	42.0	447.2	1.496
2007	n/a	39.8	376.8	46.1	41.0	503.8	1.527
2008	n/a	33.6	384.7	39.9	41.0	499.2	1.757
2009	n/a	28.0	417.6	38.8	42.0	526.4	1.754
2010	n/a	27.4	348.6	36.0	39.9	451.9	1.679
2011	n/a	26.8	248.0	26.3	43.5	344.6	1.682
2012	n/a	22.5	377.2	25.2	48.0	472.9	1.983
2013	n/a	22.4	360.0	24.65	47.3	454.35	2.115
2014*	n/a	35.0	434.4	33.0	55.0	557.4	

(Source: USDA, NASS, Crop Production Report; 2014 is October forecast)

With lower U.S. flue-production in 2013 than in 2012, exports of unmanufactured flue-cured tobacco declined as well. Exports for the 2013 marketing year were 262.2 million pounds (farm sales weight) down slightly from 269.2 for the 2012 marketing year (table 2). Exports to the EU-27 continued their downward trend falling from 77.5 million pounds for the 2012 crop to 63.8 million pounds for the 2013 crop. Exports to China continued their upward trend increasing from 59.8 million pounds for 2012 to 73.9 million pounds for 2013. The 2013 marketing year was the first year that exports of U.S. flue-cured to China exceeded exports to the EU. Demand from China continues to be strong but U.S. supply has been hampered by adverse weather that has affected both quantity and quality of recent crops. A strengthening U.S. dollar may also impede export growth in the near term. However, much larger U.S. production in 2014 should result in an increase in exports of the 2014 crop. Domestic use has trended downward with declining U.S. cigarette consumption (table 2), but has been volatile in recent years.

**Table 2: Flue-Cured Tobacco Production , Stocks, Supply and Disappearance (farm sales wt. million lb)**

Marketing Year	Beginning Stocks	Production	Total Supply	Ending Stocks	Total Use	Exports	Domestic Use
2004-2005	822.8	499.3	1,322.2	796.0	526.2	188.6	337.6
2005-2006	796.0	380.9	1,176.9	604.0	572.8	258.4	314.4
2006-2007	604.0	446.5	1,050.5	493.2	557.3	247.0	310.3
2007-2008	493.2	503.8	997.0	396.8	600.2	305.0	295.3
2008-2009	396.8	499.2	896.0	360.3	535.6	304.2	231.5
2009-2010	360.3	525.4	885.7	398.8	486.9	303.1	183.8
2010-2011	398.8	451.9	850.7	381.9	468.8	258.9	209.9
2011-2012	381.9	344.6	726.5	319.2	407.3	248.4	158.9
2012-2013	319.2	472.9	792.1	260.4	531.7	269.2	262.5
2013-2014	260.4	454.3	714.7	334.5	380.2	262.2	118.0

(Sources: USDA-AMS Tobacco Stocks as of July 1, various years. USDA-NASS. USDA-FAS GATS)

## Burley Production and Market

The supply/demand balance for U.S. burley has taken an abrupt turn after being a seller's market for several years of tight supply. Contract volume was reportedly reduced for U.S. burley growers in 2014, with some growers electing to continue to grow burley without a contract. This reaction is occurring in the midst of declining global demand for burley and increasing world burley production. According to Universal's August 2014 production report, world burley production increased 23 percent in 2013 and an additional 12 percent in 2014. Most of the growth over the past two years has occurred in Africa which is viewed as a low quality/filler tobacco, and thus doesn't compete directly with U.S. or South American quality/full flavor burley. Nevertheless, increased lower-priced leaf burley supplies are undoubtedly substituting for higher quality-premium priced burleys. The October 2014 USDA crop report has U.S. burley pegged at 211.5 million pounds, 10 percent above the 2013 crop. USDA reports burley acreage down one percent, but estimates a yield of 2,149 pounds per acre – the highest yield in the post-buyout era. However labor challenges and unfavorable weather conditions, especially during harvesting the crop will likely cause acreage harvested and yields to be adjusted downward in the coming months as well as having an adverse impact on leaf quality.

**Table 3: U.S. Burley Tobacco Production (million pounds) and Average Prices (\$/lb).**

	Kentucky	Tennessee	Pennsylvania	North Carolina	Others	U.S. Total	Avg. Price
2004	206.7	46.1	n/a	6.6	32.8	292.2	\$1.99
2005	143.5	34.0	4.8	5.0	16.1	203.4	\$1.56
2006	153.3	30.8	12.1	6.6	14.3	217.1	\$1.64
2007	161.7	20.8	11.8	6.6	15.2	216.1	\$1.60
2008	147.0	24.7	9.9	5.6	14.3	201.5	\$1.67
2009	161.3	26.9	9.4	6.3	11.0	214.9	\$1.71
2010	140.4	24.9	10.1	4.0	8.2	187.6	\$1.52
2011	128.0	22.5	11.0	3.6	7.2	172.3	\$1.75
2012	151.7	29.0	11.5	4.0	8.7	204.9	\$1.97
2013	148.0	20.4	12.2	2.7	9.2	192.5	\$2.06
2014	160.6	25.2	12.5	3.4	9.8	211.5	-

(Source: USDA, NASS, Crop Production Report, October 2014, and NASS price data)

U.S. burley disappearance (domestic use plus exports) in recent years has stabilized to around 210 to 220 million pounds, but fell in the 2012-2013 marketing year to slightly below 200 million pounds. Favorable exchange rates and tight global supplies resulted in export opportunities for U.S. burley prior to the 2012-2013 marketing year, but U.S. production levels limited expansion. Trade data reveals that U.S. burley exports remained around 110 to 120 million pounds during the past four marketing years, but increasing global supplies and some relative strengthening of the dollar likely contributed to a 25 percent reduction in U.S. burley exports for the first half of 2014. Domestic U.S. burley use is being hampered by acceleration in the decline in U.S. cigarette consumption (down 5.8 percent in 2013 with similar trends so far in 2014) and the availability of cheaper foreign leaf. Accounting for both slumping exports and domestic use, it certainly appears a 2014 U.S. burley crop near or exceeding 200 million pounds will exceed anticipated use, leading to more critical grading, and prices falling from their record high of \$2.06 per pound for the 2013 crop. Demand for low quality leaf and non-contract pounds could be challenged in this marketing environment if current forecast production levels prevail. Unless the global supply/demand balance improves, look for additional U.S. burley contract volume reductions in 2015.

**Table 4: Burley Tobacco Production, Stocks, Supply and Disappearance (farm sales weight million lb)**

Marketing Year	Beginning Stocks	Production	Total Supply	Ending Stocks	Total Use	Exports	Domestic Use
2004-2005	540.0	280.1	820.1	492.6	327.5	227.6	99.9
2005-2006	492.6	203.4	696.0	403.4	292.6	200.4	92.3
2006-2007	403.4	217.1	620.5	296.2	324.4	259.8	64.6
2007-2008	296.2	207.4	503.6	256.2	247.4	192.1	55.3
2008-2009	256.2	201.5	457.7	239.2	218.5	140.0	78.5
2009-2010	239.2	214.9	454.0	237.7	216.4	116.0	100.4
2010-2011	237.7	187.6	425.3	208.2	217.1	118.8	98.3

2011-2012	208.2	172.3	380.4	170.7	209.8	103.4	106.4
2012-2013	170.6	204.9	375.5	175.6	199.9	110.1	89.8

(Source USDA-AMS Tobacco Stocks as of April 1, 2014)

### Dark Tobacco Situation and Outlook

U.S. dark tobacco growers have enjoyed a sustained/growing demand for their leaf over the years in response to higher smokeless sales (primarily snuff) and limited foreign competition. U.S. snuff consumption has increased annually since the mid-1980s for a variety of reasons including, new product introductions, successful marketing programs, smoking restrictions, and perceived lower health risks comparable to combustible tobacco products. However, industry data for first half of 2014 indicate domestic snuff actually declined 3.2%.

Unlike burley, dark tobacco growers saw contract pounds remain similar, and in some cases increase, for 2014. Higher yields are projected to increase the U.S. dark fire cured crop to slightly above 50 million pounds and a U.S. dark air-cured crop totaling around 15 million pounds – just slightly above last year’s levels. Prices for the 2013 crop averaged a record \$2.63 (compared to \$2.58/lb in 2012) for dark fire-cured, while the 2013 dark air-cured crop averaged \$2.35/lb (vs \$2.29/lb in 2012). Look for dark tobacco prices to remain relatively strong for quality leaf. Stagnant/declining product sales may cause the industry to reevaluate additional acreage expansion in 2015. Nevertheless, the outlook for the U.S. dark tobacco growing sector remains very favorable given projected sales for smokeless tobacco products in the United States.

### U.S. Tobacco Farm Consolidation

The 2012 Ag Census (released earlier this year) revealed a further consolidation in the number of farms growing tobacco in the U.S during the post-buyout era (table 5). According to the data, just slightly more than 10,000 farms grew tobacco in the U.S. in 2012, a 38 percent reduction from 2007 and more than 70 percent reduction from the pre-tobacco buyout years. Kentucky still possesses the largest number of farms growing tobacco with nearly one-half of the U.S. tobacco farms. All states experienced a significant decline, except Pennsylvania which experienced a 28% increase in the number of farms growing tobacco since 2002. The number of tobacco farms in North Carolina, the largest flue-cured producing state, has declined by about 2/3 since 2002. With this trend flue-cured farms have become larger and more geographically concentrated with North Carolina producing a larger quantity and share of U.S. flue-cured tobacco in the post buy-out era (table 1). Additional overall consolidation is expected in the coming years in response to anticipated declining demand, technological change, regulatory action, labor challenges, and deteriorating infrastructure.

**Table 5. Number of Tobacco Farms in Selected States and U.S.**

State	Tobacco Farms (2012)	% of 2012 U.S. Tobacco Farms	Tobacco Farms (2007)	Tobacco Farms (2002)	Change Since 2007	Change Since 2002
<b>Kentucky</b>	<b>4,537</b>	<b>45%</b>	<b>8,113</b>	<b>29,237</b>	<b>-44%</b>	<b>-72%</b>
<b>North Carolina</b>	<b>1,682</b>	<b>17%</b>	<b>2,662</b>	<b>7,850</b>	<b>-37%</b>	<b>-66%</b>
<b>Tennessee</b>	<b>935</b>	<b>9%</b>	<b>1,610</b>	<b>8,206</b>	<b>-42%</b>	<b>-80%</b>
<b>Pennsylvania</b>	<b>1,312</b>	<b>13%</b>	<b>1,152</b>	<b>897</b>	<b>+14%</b>	<b>+28%</b>
<b>Virginia</b>	<b>558</b>	<b>6%</b>	<b>895</b>	<b>4,184</b>	<b>-38%</b>	<b>-79%</b>
<b>Ohio</b>	<b>224</b>	<b>2%</b>	<b>475</b>	<b>1,845</b>	<b>-53%</b>	<b>-74%</b>
<b>Georgia</b>	<b>102</b>	<b>1%</b>	<b>224</b>	<b>822</b>	<b>-54%</b>	<b>-73%</b>
<b>Others</b>	<b>664</b>	<b>7%</b>	<b>1,578</b>	<b>3,936</b>	<b>-40%</b>	<b>-73%</b>
<b>Total U.S.</b>	<b>10,014</b>	<b>100%</b>	<b>16,234</b>	<b>56,977</b>	<b>-38%</b>	<b>-72%</b>

Source: USDA Census of Agriculture