

TOBACCO SITUATION AND OUTLOOK FOR 2006

A. Blake Brown and Dewitt T. Gooden

2006 PRODUCTION

According to the U.S. Department of Agriculture's (USDA) November *Crop Production* report, U.S. flue-cured tobacco acreage was estimated at 208,000 in 2006, up about 18 percent from 2005. At 2,181 pounds per acre, average yield was about the same as in 2005. The 2006 flue-cured tobacco crop production estimate was 454 million pounds, up 19 percent from 383 million pounds in 2005. Within North Carolina, the largest flue-cured producing state, acreage increased about 20 percent to 150,000 acres according to the November *Crop Production* report. Most of this increase was in the eastern part of the state. Production in North Carolina was estimated at 330 million pounds, up from 274 million pounds in 2005. Production in South Carolina for 2006 was 46.2 million pounds grown on 22,000 acres. This is up from 42 million pounds grown on 20,000 acres in 2005.

Despite the increase in U.S. flue-cured production, global flu-cured production was estimated to be down about 4 percent in 2006, according to the October 2006 *World Leaf Production Summary* by Universal Leaf Tobacco Company. According to this report, the 2006 Brazil crop was about 1.39 billion pounds, down about 9 percent from 2005. With the 2007 Brazil crop planted, production in Brazil for 2007 is projected to be less than 1.3 billion pounds. If 2007 Brazilian production is down, then companies may increase incentives to expand U.S. flue-cured production again in 2007.

PRICES AND COSTS

Tobacco market prices are difficult to estimate because official market reporting was eliminated with the buyout. Variation in prices among contracts was less than in 2005. There were fewer growers without contracts, and some companies (generally those with prices in 2005 well below the average) increased their prices. As in previous years, one buyer bought a majority of the 2006 crop, at prices similar to their 2005 prices. The average flue-cured price for 2006 was likely around \$1.50 per pound, slightly higher than in 2005.

Fuel and fertilizer costs increased dramatically in 2006. The largest increase in production costs is for labor. Most farmers have had to transition to use of H2A labor – a more costly alternative to many traditional forms of labor that are no longer available. With a higher adverse wage rate and higher acquisition costs, the cost of H2A labor rose substantially. The outlook for significant reform of immigration labor law is not promising. Higher cost and restricted availability of labor pose very significant barriers to further expansion of U.S. flue-cured. As a result of higher labor and fuel costs, profits declined in 2006 despite a slight increase in prices. Substantial increases in the cost of production without accompanying price increases will hamper further expansion of the U.S. crop.

The downward trend in total disappearance of U.S. flue-cured tobacco seems to be slowing according to USDA reports. At 309 million pounds, estimated 2005 domestic use of U.S. flue-cured is lower than in 2004, but higher than use in 2003. Prior to 2003, domestic use had been declining steadily since the mid-1990s. Exports of flue-cured, estimated at 195 million pounds for 2005, rose for the first time since 2001. Lower prices following deregulation of U.S. tobacco production have likely influenced this potential turnaround in U.S. flue-cured disappearance.

Additional information on the situation and outlook for flue-cured tobacco may be found at: www.ag-econ.ncsu.edu/extension or www.ers.usda.gov.

THE TOBACCO TRANSITION PAYMENT PROGRAM

Producers and former quota owners received the second of 10 payments from the tobacco buyout in 2006. Information on the Tobacco Transition Payment Program can be found at www.fsa.usda.gov/tobacco.

Information on the tax implications, investment decisions or other issues related to the tobacco buyout can be found at www.tobaccobuyout.cals.ncsu.edu.

2007 TOBACCO BUDGET

(Compiled by Dewitt T. Gooden and Wilder Ferreira)

Two production system budgets are estimated for next year. These are the multi-pass machine/bulk barn (MM) and the hand harvest/bulk barn (HH) systems. Both are used in this state. As compared to 2006, input costs are projected to be higher for fertilizer and chemicals and higher for energy costs (curing and machinery) and labor. Overall, costs are increased from last year.

ESTIMATED S.C. 2006-07 PRODUCTION COSTS FOR TWO TOBACCO PRODUCTION SYSTEMS; 2,200 AVERAGE YIELD*

Item	Production System	
	HH (Hand)	MM (Machine)
VARIABLE COSTS:		
Transplants	\$172.25	\$172.25
Fertilizer	163.33	163.33
Herbicides & Fungicides	95.81	95.81
Insecticides & Nematicides	234.14	234.14
Sucker Control	113.31	113.31
Curing Costs	600.60	600.60
Baling, Hauling & Storage	275.00	275.00
Research Assessment	2.20	2.20
Crop Insurance	25.00	25.00
Tractor/Machinery	230.67	263.53
Labor	978.95	693.84
Interest on Op. Cap.	45.43	46.91
TOTAL VARIABLE COST:		
	per Ac.	\$2,936.69
	per Cwt.	\$1.33
FIXED COSTS:		
Tractors & Machinery	252.12	396.85
Curing Barn	330.00	330.00
Greenhouse	69.00	69.00
TOTAL FIXED COST:		
	per Ac.	\$651.12
	per Cwt.	\$0.30
OTHER COSTS:		
Land Rent	50.00	50.00
General Overhead	264.30	241.73
TOTAL OTHER COSTS:		
	per Ac.	\$314.30
	per Cwt.	\$0.14
TOTAL ALL COSTS:		
	per Ac.	\$3,902.11
	per Cwt.	\$1.77

<u>BREAK-EVEN</u>	<u>YIELD</u>	Hand	Machine	<u>BREAK-EVEN</u>	<u>PRICE</u>	Hand	Machine
<u>(lbs)**</u>				<u>(\$/lb)</u>			
	Variable Costs	1870	1642	Variable Costs		\$1.33	\$1.22
	Total Costs	2765	2645	Total Costs		\$1.77	\$1.72

*These budgets are for comparison purposes only. Each producer should generate his own budget.

**Based on price of \$1.50/lb.

Updated versions of Flue-Cured Tobacco Budgets can be viewed and downloaded at:
http://cherokee.agecon.clemson.edu/crop_bud.htm or www.ag-econ.ncsu.edu/extension.

POTENTIAL NET RETURNS (Compiled by Dewitt T. Gooden and Wilder Ferreira)

These three tables compare potential net returns for 2007. The tables consider (machine harvest-bulk barn) yields varying from 1,800 to 2,600 pounds per acre and estimated sale price ranging from \$1.35 to \$1.65 per pound. The first table covers net returns per acre above variable costs. The second covers net returns per acre above variable and fixed costs. The third table covers all costs per acre and represents net returns above management and risk. Each producer must calculate their own costs and break-even situations.

**2007 ESTIMATED INCOME ABOVE VARIABLE COSTS
 AT DIFFERING YIELDS AND PRICES: PRODUCTION SYSTEM MM***

	Price (\$/lbs)				
	\$1.35	\$1.45	\$1.50	\$1.55	\$1.65
1,800	-96	84	174	264	444
2,000	94	294	394	494	694
2,200	284	504	614	724	944
2,400	474	714	834	954	1,194
2,600	664	924	1,054	1,184	1,444

**2007 ESTIMATED INCOME ABOVE VARIABLE & FIXED COSTS
 AT DIFFERING YIELDS AND PRICES: PRODUCTION SYSTEM MM***

	Price (\$/lbs)				
	\$1.35	\$1.45	\$1.50	\$1.55	\$1.65
1,800	-892	-712	-622	-532	-352
2,000	-702	-502	-402	-302	-102
2,200	-512	-292	-182	-72	148
2,400	-322	-82	38	158	398
2,600	-131	129	259	389	649

**2007 ESTIMATED INCOME ABOVE ALL COSTS
 AT DIFFERING YIELDS AND PRICES: PRODUCTION SYSTEM MM***

	Price (\$/lbs)				
	\$1.35	\$1.45	\$1.50	\$1.55	\$1.65
1,800	-1,170	-990	-900	-810	-630
2,000	-987	-787	-687	-587	-387
2,200	-804	-584	-474	-364	-144
2,400	-620	-380	-260	-140	100
2,600	-437	-177	-47	83	343

*MM = machine harvest, bulk barn