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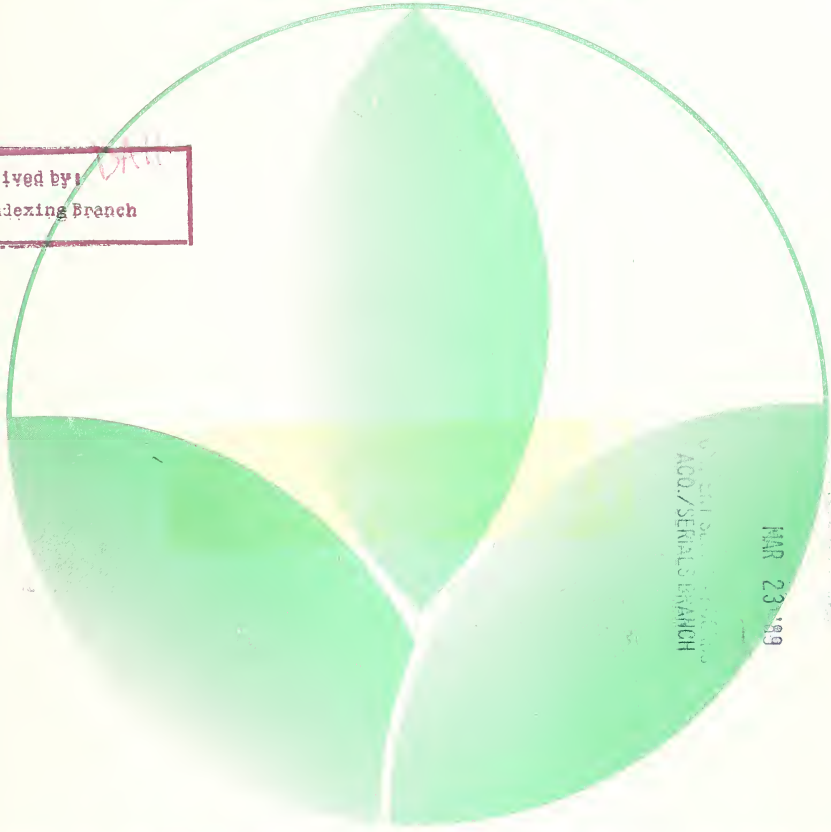
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TOBACCO MARKETING ISSUES

T. Carlton Blalock
Executive Vice President

Tobacco Growers Association of North Carolina, Inc.

I commend those who planned the program for this year's Agricultural Outlook Conference for including a topic on marketing in the tobacco section. Our Association feels there are opportunities for improving the way we market our tobacco and we have taken the lead in calling this to the attention of the total tobacco industry. We hosted a two-day tobacco marketing conference earlier this year and believe the groundwork was laid for some progressive changes in the years ahead. Every issue I will discuss today was identified as an important concern by those attending our conference.

My comments will be largely from the perspective of the grower and will focus on flue-cured tobacco since the marketing of each type of tobacco differs so much that it would be difficult to generalize. It would also be impossible to cover every issue relating to the marketing of flue-cured tobacco in the time assigned to me. Therefore, I've identified what I consider to be seven of the most important issues facing the industry. In some instances, I will suggest solutions, but in others I leave it to the industry to make those choices.

For any commodity, the cost of a particular input and the return for that cost represents the basis by which the producer evaluates that input. Tobacco marketing costs are no different. Farmers want to feel they are getting the best possible return from these marketing costs since they do represent a significant item among all operating inputs. The North Carolina Agricultural Extension Service budget for flue-cured tobacco for 1988 estimated selling charges and marketing assessment at \$151 per acre, second only to curing fuel among operating inputs exclusive of land, quota, labor, capital, machinery, overhead and management. Put another way, marketing costs are estimated at 6.6 cents/lb. As a comparison, fertilizer costs are estimated at 5 cents/lb. and pesticide costs, including sucker control, at 9.2 cents/lb.

I am not suggesting these costs are too high or too low. Growers are aware, however, that in other major tobacco producing countries marketing costs do represent a lower percentage of their total costs, giving them a slight competitive edge in the world market. We believe marketing costs need to be scrutinized as carefully as any other input and, if there are opportunities to reduce this cost or return a greater benefit for the same cost, we need to make changes. In discussing some of the other issues I will suggest areas where we believe some additional efficiencies can be achieved.

A second issue on the minds of many tobacco people this year is how to best handle tobacco produced in excess of that years marketing quota, due to a particularly favorable growing season. The 1988 season was a classic example of this problem.

For a number of reasons, which I won't take time to enumerate, many growers found themselves with substantial up stalk tobacco still on hand after they had sold their marketing quota for 1988. It was also some of the best tobacco of their entire crop, tobacco the trade also said it needed to fill their orders. Storing that tobacco on the farm until the 1989 marketing season opens will, at best, result in some deterioration in quality. Many argued that we should have been able to find a way to let the trade take this tobacco and process it in order to preserve the almost vintage quality of the 1988 crop and, hopefully, help them retain some orders that they might otherwise lose. At the same time, however, growers in the Old and Middle belt felt if such a program was authorized it would have a negative impact on their market. Both arguments had merit.

1988, however, will not be the last year we will have a problem with excess production. Our Association believes we need to look at two policy issues that impact this problem. The first is the inability of ASCS to adjust acreage/poundage ratios on an individual farm basis. Under current law these ratios can be adjusted only on a countywide basis. This has no impact on the farmer who has a poundage base of 1800 pounds per acre but who can easily make 3,000 pounds. Or, those individuals, but much fewer in number, who cannot make their pounds on their allotted acres. As long as this situation continues, we will have substantial excess production on many farms, and it will be exacerbated in those years in which we have favorable weather. It's true, growers could adjust production by reducing their acreage but that goes against their basic nature. They'd rather have too many pounds than not enough and they will plant accordingly.

We also believe, in light of our experience in 1988, we need to reexamine the policy change written into the 1986 Tobacco Reform Act that reduced from 110 percent to 103 percent the amount of

total quota a producer can market each year. With weather as variable as it is, a 3 percent allowance for excess production in a good growing year, like 1988, may be too small. Some will argue that a 10 percent allowance is too great. However, I believe there is general consensus that 3 percent is too little.

One solution to our dilemma this year, suggested by our Board of Directors, assuming a way could be found to authorize some type carryover/storage program, was to first of all, after the market closed, accurately determine how much carryover tobacco farmers had on hand. During the burley marketing season the trade could be surveyed to determine the demand for that amount of carryover tobacco. If it was deemed to be sufficient, the flue-cured markets could be re-opened briefly immediately after the burley markets closed. This type program would not impact the Old Belt markets, it would better preserve the quality of this tobacco, it could help export companies hold some accounts it might otherwise lose for U.S. tobacco and it would empty curing barns prior to the 1989 harvesting season.

The number one marketing issue in the minds of growers, year in year out, however, is the grading system. For them, this is the focal point of the auction since they believe the grade placed on a sheet of tobacco substantially influences what the trade will pay for it. The most common complaint is inconsistency in grading. In defense of the graders and the system, I must acknowledge that most growers do not fully understand the standards on which the grading system is based. We need to better educate growers, not only so that they will be less critical, but because it will help them improve the overall quality of their tobacco. This will not completely solve the problem of inconsistency because interpreting and applying these standards is still an individual subjective judgment. Growers are likely to always see their tobacco in a more favorable light than either the grader or the buyer. That's human nature.

One also has to wonder if human judgment is precise enough to accurately and consistently distinguish between 143 different grades, the number on the 1988 schedule. Would our grading be more consistent and uniform if we had fewer grades? Some argue on the other hand, that we need even more grades to accurately describe the wide range of tobacco offered for sale each year. In any event, we need to attempt to find ways of increasing the confidence of the grower in the consistency and fairness of the grading system.

One answer may lie in the use of some objective methods of evaluating the quality and utility of tobacco, in addition to our present subjective method. Such technology is available and we believe it needs to be field tested to determine its usefulness in the market. Scientists at North Carolina State University

have experimented with the use of near infrared spectrometry equipment to quickly measure various quality factors and chemical constituents in tobacco. Within a matter of seconds, it is possible, using this equipment to accurately determine moisture content, nicotine, sugars, nitrogen and some 15 other constituents in tobacco. It can readily sense wet tobacco and the presence of plastics and other foreign materials. The tobacco manufacturing segment of our industry already uses this technology extensively to monitor the composition of tobacco going into their blends.

Changes in the current grading system must come gradually to be accepted by all segments. It seems appropriate to begin field testing the use of near infrared technology in parallel with our current grading system. As we gain experience with it and growers develop confidence in its reliability, it could become the dominant method by which we establish a utility value on an individual lot of tobacco.

One of the obvious ways of reducing the cost of marketing flue-cured tobacco would be to sell it in larger lots. If, for example, we could go to bales or some other packaging system and sell in lots of 1,000 pounds instead of 275 pounds, as we're now limited, you might substantially cut your cost. In our marketing conference, however, there was unanimous agreement that until we can solve the problem of product integrity - basically nesting and excessive mixing of grades - we cannot make any significant changes in the current method of packaging tobacco for sale. Nesting continues to be a significant marketing issue, even though estimates of the percentage of tobacco that is nested varies from only 2 to 5 percent. It's still an issue we must resolve. We believe stiffer penalties must be imposed on anyone - whether it's a grower, a warehousemen or a dealer - who nests tobacco, before we can eliminate this problem. Currently, ASCS says it has no authority to penalize warehouseman or dealers. Before growers are willing to accept stiffer penalties they insist that others be subjected to the same standards to which they are held. We believe a way must be found to do that.

Also related to the issue of product integrity is the problem of illegal and/or excessive pesticide residues in our tobacco. This issue is important, not only because of the concerns of our export customers, but because it is also an issue that can be exploited by the anti-smoking groups. The industry recognized this and demonstrated what it can do when the dicamba problem surfaced in 1986, by responding quickly and decisively. In 1987, concerns were raised by some of our European customers over the abnormally high residues of maleic hydrazide, a chemical registered for the control of suckers, in the tobacco they purchased that year. We believe weather was a significant factor in causing those high numbers but, nevertheless, intensified our

educational and market monitoring program for this material in 1988. The program proved successful since we were able to reduce residue levels of maleic hydrazide on the 1988 crop to their historical level. However, action proposed in October of this year by the government of Italy indicates that level may not be low enough. Italy is considering a regulation that would establish a legal tolerance for maleic hydrazide on re-dried leaf tobacco of 50 ppm, a level we will have difficulty meeting. Compounding the seriousness of this proposal is the reality that if Italy establishes this tolerance it's likely that most other European countries will follow and that would be devastating to our export market. We must continue to educate growers on the seriousness of pesticide residue problems and also continue a pesticide monitoring program similar to the one in place for both the 1987 and 1988 marketing season.

The recent allegations that some U.S. tobacco exports containing imported tobacco have been represented as 100 percent U.S. grown, whether the charges prove to be true or not, have damaged our credibility as a world supplier. We need a certification program that assures our customers that they know exactly what they are getting when they buy tobacco from the U.S. Our Association has been calling for such a certification program for two years. We have requested legislation that would require exporters of U.S. tobacco to indicate at the time of export whether the tobacco is of U.S. origin, foreign origin or mixed origin. For tobacco of mixed origin, the exporter would be required to indicate on a certified report the quantity of imported tobacco contained in the shipment from each foreign source. Such a certification program would do much to restore our credibility with our customers throughout the world and we believe it should be put in place as soon as possible.

A fifth issue we must come to grips with is to find a way, in our current price support program, to adjust prices on individual grades to respond to the changing demands of a world market. In recent years, the demand and relative value for certain styles and types of tobacco - i.e., cutters - has changes and will probably continue to change. We have responded in this particular case by reducing the support price on some of the C and X grades by as much as 9 cents/lb. in the last two years. Yet, a higher percentage of these grades continue to go under loan compared to other grades, indicating they may still be over priced. The law, of course, requires that when the price is lowered on one grade it must be raised on another grade in order to maintain the overall average at its original level. In order to do this, we've been forced to increase the support price on some of the B grades - normally our export tobacco - by as much as 8 cents/lb., causing alarm and concern among some of our export customers. How much further we can go toward this problem using this approach is a real question.

Farmers face a real dilemma. Most contend they cannot afford to market lower stalk tobacco when they have the capability of producing enough tobacco to replace it with higher priced middle and upper stalk tobacco. As a result, the trend has been to harvest fewer and fewer primings and lugs. At the same time, some manufacturers have expressed concern that, if this trend continues, they may not be able to purchase on our market the amount of primings they need each year to maintain their current blends. They say that could force them to go offshore for these tobaccos and the fear, of course, is that when they do they'll also buy other tobacco.

As growers we cannot afford to ignore the concerns of our customers. However, economics make it difficult to convince a grower that it's in his long term best interest to sell \$1.40 tobacco when he knows he can grow enough pounds to replace it with \$1.75 tobacco.

One alternative that has been suggested would be to authorize the Secretary of Agriculture to identify certain grades of tobacco that appear to have very limited demand at present support prices. He would also be authorized to allow growers to market a certain percent of their total quota - say 5 percent - of tobacco in those grades, without price support but would not count against their marketing quota. The grower would then have a choice. If he felt he could make money at the price the market was willing to pay for those grades of tobacco, he could harvest them and still market his full quota of higher priced tobacco. The approach is not without problems. Grading and classification of tobacco, as I pointed out earlier, is not that precise. Serious disagreement could arise as to whether a particular lot of tobacco qualified for the exemption. Purchasers might also find they could substitute these grades of tobacco for other grades, causing those supported grades to then be in excess supply. Nevertheless, I feel the problem is one that we must address and somehow find a system that allows us to better respond to the changing demands of our market.

Superior quality has always been the trademark of U.S. tobacco. Compared to most other major producing countries, our tobacco is still more expensive on a pound-for-pound basis. The margin of our quality difference continues to be a major factor in how competitive we are. For that reason, educational programs have emphasized the production and marketing of high quality tobacco. Some of the recommended practices, such as more frequent harvesting and grading and sorting of tobacco as it comes from the bulk barn, have added to the grower's production cost but the promise was the market would more than pay for that cost. Growers have found that has not always been true. In some years, particularly if the crop was short, there's been essentially no premium for quality. Everything sold for the same price, making

it difficult to be convincing when emphasizing costly production practices that lead to higher quality tobacco.

The average grower has not felt he was paid enough differential to economically justify the expense of extra harvesting or any cleaning up or grading of his tobacco as he prepared it for market. We had begun to make some progress on more frequent harvesting as a way of marketing only ripe, mature tobacco that was separated by stalk positions. During 1988, however, some growers who harvested 5 to 6 times have indicated they feel they were actually penalized because they had a lot of tobacco graded as cutters, and those grades didn't sell well. They say neighbors who harvested their primings and then waited long enough so they could harvest only twice more, had no cutter grades and thus sold their crop for a higher average.

If the trade wants ripe, clean tobacco that is separated by stalk positions, they must be prepared to reward those who offer it for sale and penalize those who do not. Farmers read economic signals very well and will respond accordingly.

The final issue I want to raise relates to the need to develop an improved system of packaging tobacco when it's offered for sale and one that lends itself to a more efficient materials handling system. Grading excepted, growers complain more about availability and quality of tobacco sheets than any other item relating to marketing. Efforts are being made to find a disposable sheet that would be acceptable from a cost standpoint. This alone would solve many problems, including the image of our market and the waste that is associated with poor quality sheets.

However, there may be other packaging alternatives that offer more opportunities for improving the efficiency of our marketing system and we believe they should be researched. Many years ago, the Agricultural Research Service piloted a tobacco marketing system utilizing cardboard boxes that could be moved easily by conveyor belts and trolleys, thus reducing labor on the warehouse floor and virtually eliminating waste. Much of that research may still be relevant today.

During our marketing conference, the group brainstormed on what might be an ideal material handling system for the marketing of tobacco. They envisioned a system whereby a grower could deliver his tobacco in bulk to the auction center. It could be unloaded into a conveyor where it could be graded, as the grower watched, almost certainly eliminating any nesting problems. Using the near infrared spectrometry equipment, moisture content and chemical analyses could be run and printed out for both the grower and prospective buyers. Samples could be pulled by the graders for the buyer to inspect during the auction. The tobacco

could be repackaged, by grades, into configurations suitable for an efficient state-of-art materials handling system. They saw two options for the actual selling: First, the tobacco could be stored on the floor for walk-by selling, as we now do it, or it could be moved to the buyers who would be located in an air conditioned area with constant and uniform light. Following the sale the tobacco could be conveyed directly to shipping points for loading out on buyer trucks.

The technology exists to do all of this. It's a matter of somehow putting it all together and field testing it to find a system that adequately serves the needs of growers, warehousemen and buyers.

Agriculture, per se, has long been guilty of placing far more emphasis on production problems than on marketing. Tobacco is subject to that same criticism. The time has come, however, where we may see more response from efforts placed on improving our marketing system for flue-cured tobacco than from additional work on production.