Tobacco Road Faces New Dose of Challenges

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Article:

These are not the best of times for the tobacco industry. President Obama just signed legislation that would place tobacco products under the regulatory purview of the Food and Drug Administration. Among tobacco manufacturers, Richmond-based Altria Group, which owns Philip Morris, supported the bill. The Triad's tobacco companies, Reynolds American and Lorillard, opposed it.

But there's more. Gov. Bev Perdue wants to raise the state tax on a pack of cigarettes by a dollar, up from the current 35 cents. That's on top of the recent increase in the federal excise tax. The governor also approved a bill that will ban smoking in all public restaurants and bars.

Even for an industry that's worn a target on its back for years, this is a lot to digest. What are the implications for the tobacco industry?

The answer depends on whom you ask. Altria clearly thinks that FDA regulation will be good for Philip Morris, which sells more cigarettes in the U.S. than all other companies combined. Altria appears to be hoping that its powerhouse Marlboro brand is so firmly ingrained in consumers' minds that new restrictions on marketing will act like a caution flag in a NASCAR race, preventing smaller companies from overtaking the leader.

Not all the news is bad for Reynolds American and Lorillard. The law does not ban menthol cigarettes, as was urged by anti-tobacco groups. The two companies' Salem, Newport and Kool brands account for more than half of all menthol sales.

Ironically, tobacco regulation could backfire in a way. In addition to regulating advertising and promotion, the FDA will closely regulate nicotine levels and ban various flavorings believed to attract young smokers. If these measures limit companies' ability to differentiate their brands on the basis of quality, they'll have no choice but to compete on price. That will drive prices down, encourage more smoking, and at least partly counteract the government's efforts to reduce smoking.

As for the new cigarette taxes, don't fret too much for the tobacco companies. To be sure, the tax hikes will raise the price smokers pay, and that will reduce cigarette purchases and cut into the bottom line. But the cut won't be deep because tobacco's addictive nature implies that decreases in consumption will be small. Smokers do cut back when prices rise, but not by much.

The expansion of North Carolina's smoking ban is clearly bad news, however, because it's a reflection of the ongoing decline in smoking, the increasing assertion of rights by nonsmokers, and the shrinking importance of tobacco in the state economy.

In the 1970s, roughly 40 percent of Americans smoked; now just over 20 percent do. The output of the nation's cigarette factories has declined by 40 percent over the last 30 years. In the last 20 years, employment in tobacco manufacturing has fallen 48 percent in North Carolina. Tobacco manufacturing employs only 0.3 percent of North Carolina's work force, and tobacco farming employs even less.

North Carolina is still the nation's top producer and exporter of unmanufactured tobacco, and tobacco is still the state's leading crop. But tobacco accounts for only about 7 percent of the state's farm income. The big money is in chickens, hogs and turkeys, which generate over half of all North Carolina farm receipts.

The recent developments are just the latest changes forced upon the tobacco industry. It will survive. But because our society and economy have changed as well, fewer of us outside that industry have a stake in its survival.