GOING INTO 2021:
CURRENT STATE OF THE SECTOR
AND THE FUTURE AHEAD
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International Tobacco Growers’ Association (ITGA) 35th Annual General Meeting (AGM) marked a pivotal moment for our organization. Due to the unprecedented disruptions caused by Covid-19, we had to significantly alter the way we interact. For the first time in history the AGM was held in a digital environment. In the midst of great uncertainty we acted quickly and decisively to guarantee we are as close to our members and supporters as possible. Our sincere hope is that in-person meetings will reconvene in 2021 but until then ITGA’s virtual platform will remain the key access point and source of information. Our objectives remain intact- to help growers make informed production decisions and overcome the challenges posed by the global pandemic, promote the long-term sustainability of the sector and drive effective advocacy while monitoring the evolving global and regional regulatory frameworks. Therefore, we are taking the opportunity to start the year with an overview of the current state of affairs for growers along with the future expectations that were highlighted during the AGM.
2020: A DIFFICULT YEAR
MADE WORSE BY COVID-19

The evolution of tobacco leaf production in the last 5 years together with the 2021 forecasts sets the scene for what is likely to be the new normal for the sector (see Graph 1 and Graph 2). 2020 data shows a picture of record decline (5.8% on a yearly basis) for all tobacco types. Flue-Cured Virginia tobacco (FCV), which accounts for more than 80% of the most popular tobacco types, is the main contributor to this decrease. In fact, above average FCV drops were registered in all regions but the biggest impact came from Africa and the Middle East. Nevertheless, a small rebound is expected in 2021, as hopes of certain normalization remain in place in most regions. Adverse weather conditions, ever growing production costs, combined with razor thin margins, and the disruption caused by the Covid-19 pandemic all played a role in shaping the sector’s direction.

**Graph 1: World Tobacco Leaf Production by Tobacco Type (million green leaf kg)**

<table>
<thead>
<tr>
<th>Year</th>
<th>Dark Air-Cured</th>
<th>Oriental</th>
<th>Burley</th>
<th>FCV</th>
</tr>
</thead>
<tbody>
<tr>
<td>2016</td>
<td>109</td>
<td>171</td>
<td>580</td>
<td>3,875</td>
</tr>
<tr>
<td>2017</td>
<td>117</td>
<td>188</td>
<td>580</td>
<td>3,845</td>
</tr>
<tr>
<td>2018</td>
<td>124</td>
<td>155</td>
<td>591</td>
<td>3,636</td>
</tr>
<tr>
<td>2019</td>
<td>117</td>
<td>163</td>
<td>547</td>
<td>3,629</td>
</tr>
<tr>
<td>2020E</td>
<td>121</td>
<td>152</td>
<td>471</td>
<td>3,436</td>
</tr>
<tr>
<td>2021P</td>
<td></td>
<td></td>
<td>461</td>
<td>3,510</td>
</tr>
</tbody>
</table>

*Source: Universal Leaf Tobacco Company*
The global pandemic resulted in lack of inputs for tobacco farming due to travelling and transport restrictions in virtually all regions. In the Americas, there was shortage of workers in the harvesting season due to complications in earning visas and travelling restrictions. In India, the decrease in public transportation frequency caused logistics havoc, while the lack of international leaf dealers, especially from China, resulted in a decrease in the expected crop price. The pandemic also caused delays at the beginning of the marketing season in two of the most important tobacco growing countries—Zimbabwe and Malawi. In some places, growers were prohibited from being present during the sales process, instead they were represented by associations. The lack of long-term storage facilities was another pandemic intensified issue that led to loss of tobacco weight, increased dryness and diminished crop quality. Ultimately, the lower consumption of tobacco products manifested in a decrease in leaf demand. In Argentina exports fell by 25%, while Brazil suffered a high single-digit drop partly attributed to the negative impact of Covid-19.

The 2021 leaf production outlook is better for FCV due to expected production increases in the US, Brazil and the wider Africa and Middle East regions. However, total production will generally remain lower compared to the 2019 levels. Alternatively, Burley is forecast to suffer another yearly drop, especially due to likely double-digit declines in Brazil and the US. Finally, the two smaller tobacco types- Oriental and Dark Air-Cured are also in decline, although a clearer picture is going to emerge in the months to follow.
UPDATES FROM MAJOR TOBACCO GROWING MARKETS

Zimbabwe / Being one of the biggest tobacco producers in the world, as well as the one where tobacco generates a significant proportion of the country’s exports (18% in 2019), makes the market a key barometer for sector-wide trends. Zimbabwe produced around 100 million kg of tobacco in 2010 and significantly increased its capacity, averaging at around 200 million kg, by the middle of the decade. This was followed by record performances in 2018 and 2019, surpassing the 250 million kg barrier. However, the 2019 peak resulted in overproduction that ultimately led to lower prices and a drastic decrease of the number of growers involved. This highlights the importance of accurate tracking and planning mechanisms that could act as safeguards to abrupt supply and demand related issues. Consequently, the 2020 production figures declined but there are positive signs for 2021. According to the latest data, there will be more new growers in the new season while production should also go up.

Due to the shorter crop, prices are expected to remain stable but foreign buyers are often discouraged due to inconsistent national monetary and fiscal policies. Uncertainties around exchange rates, black market currency dealings and payment methods have all caused issues for local growers during the last few years. Regardless, more than 95% of the crop is likely to get exported, with China and the EU being the main destination markets. Deforestation continues to be a major problem which needs to get solved urgently, with many companies engaging in their own initiatives.

Covid-19 posed real problems including decentralization of tobacco selling points and volume drops of auction floors. In fact, the incoming season is forecast to show 97% of the crop getting contracted and mark the end of auction floors altogether. With the sudden decision to decentralize buying, side marketing and increase in middle men became a real problem once again. Nevertheless, measures are being taken to ensure only buyers with export orders could purchase tobacco. In the future, Sustainable Tobacco Production and Due Diligence, especially due to multiple EU buyers, will be a focus area for Zimbabwean growers so they can continue to attract international buyers.

Malawi / Tobacco is simply put the most important crop in Malawi. In addition to being the country’s principal export crop, providing around 50% of the Malawi’s foreign exchange earnings, it also accounts for 11% of GDP. Burley comprises 84% of all tobacco varieties grown, followed by FCV with 13%, while the rest having marginal share of the totals.

The 2019/2020 season showed a significant decrease in tobacco production- 114,000 tonnes compared to 202,000 tonnes in 2018/2019. However, the average prices in 2019/2020 were slightly higher compared to the year before (USD 1.53/kg vs USD 1.43/kg). Regardless, the price level has largely stagnated while costs of living are constantly
going up. Another key issue for local farmers during the last season was associated with high rejection rates, especially on auction Burley due to low quality production. The 2019/2020 season saw an increase in licenses to above 50,000 and the resulting 114,000 tonnes meant that many growers did not produce despite obtaining the license. The outlook for the 2020/2021 season is for licenses to go down to 45,000 with an expected production of 163,000 tonnes. However, considering last year’s developments this target might not be reached.

Despite the growing uncertainties, there are good news regarding crop alternatives. The Cannabis Production Law has passed in the local Parliament and the Government is setting up regulatory framework, thus giving hope to farmers for the future.

**India /** India is another key tobacco market on the global scene. It is the second largest tobacco producer, providing livelihood to 46 million people, 6 million being farmers, and bringing around USD 6 billion in tax revenue. Despite these impressive figures, only 9% of the tobacco consumed comes in the form of cigarettes. The remaining 91% are attributed to country-specific products, mainly smokeless, such as bidis, chewing tobacco and hookah, among others.

Quite naturally, the local crop evolution is strongly determined by the smokeless consumption dynamic. During the 2019 season FCV accounted for roughly 27% of the total tobacco production, or 236 million kg, while Burley and Oriental, for another 10% or 82 million kg. Since bidis and chewing tobacco are predominantly locally consumed, FCV, Burley and Oriental form the largest share of exported production. The pandemic had a major influence on the 2020 season when the initially expected 235 million kg of FCV were reduced by the local tobacco board to 203 million kg. This was motivated by disruptions in global demand. The optimistic scenario for 2021 shows going back to normality or around 260 million kg, assuming more demand and higher production.

**Italy /** The current crop evolution in the country is illustrative of the sector’s state in the EU. Italian growers experienced a very challenging 2019 season, especially concerning price. As a result, 2020 started with fewer farmers, as many swapped to other cultivations because they were unable to cover their operating costs. In addition, the latest EU Track and Trace Directive put unmanufactured tobacco in a state of limbo and created logistics complications. Bad weather, with untypical thunderstorms, even tornadoes, floods and hail resulted in 15% to 20% loss of production.

All these factors reaffirmed the steep decline in production volume terms, a trend that intensified during the last 2 years. In fact, the real production level of around 35-40,000 tonnes in the 2020 season, represents half of the quantities that were available a dec-
Subsidies have also decreased substantially to around EUR 2,000/ha and are likely to completely disappear by 2023. Other financial assistance is nearly impossible to obtain.

The future outlook of the Italian and the EU market seems to be destined for concentration of production in a handful of countries, mainly Italy, Spain and Poland, and feeding local consumption needs with imported tobacco.

Argentina is another key tobacco producing country, where 2% of the population relies on the income generated by the sector, or around 1 million people. In the Salta region, this dependence is the highest, 23%.

The country has experienced a stable 2019/2020 season. Total production amounted to 113,000 tonnes, 62% of which being FCV, centered in Jujuy and Salta, and another 34% Burley, mainly coming from Misiones and Tucuman. Around 85% of the local production is getting exported, with destinations spread from the Americas to Europe and Asia. All provinces where tobacco is produced have generally maintained the last season’s production volumes. However, the effects of Covid-19 means that the new season could be more difficult.
INDUSTRY TRENDS 
AND THE INCOMING LEGAL 
CANNABIS SECTOR

In 2020, just over 5 trillion cigarette sticks were sold around the world (see Graph 3), a 5.6% year-on-year decline if we exclude the biggest global market—China. The industry lost around a trillion sticks during the last decade, with an expected fall below 5 trillion units for the first time in 2021. Regardless, the industry’s performance has been more robust than many anticipated. In times of a global pandemic and incoming financial recession, the flattish value performance of the biggest tobacco category feels like a small victory to major manufacturers. Going into the future, cigarette volumes are likely to decline by a total of 12%-13% by the middle of the 2020s, underscoring the increasing difficulties in generating meaningful value growth.

**Graph 3: Global Cigarette Market Overview**

In emerging categories there are signs of certain weaknesses, especially in the US, where migration away from combustible products has slowed down. Nevertheless, closed e-vapor systems and heated tobacco are projected to nearly double their global size in value terms by 2025-2026. Another product type that is likely to benefit from changing consumer preferences, partly affected by Covid-19, is tobacco-derived nicotine pouch products that reached around USD 1 billion in sales in 2020. Ultimately, alternative products will remain a fragmented category, with no clear preference of a single product type.

In terms of market developments in cigarettes, the places that are likely to see both volume and value growth are becoming even more constrained. Iraq, Bangladesh and Vietnam are among the few remaining growth drivers. Having had similar trajectory in the near past—Egypt and China, will find it increasingly difficult to register positive performances. This is partly driven by stricter regulations and ever growing excise increases.
Interesting examples of cigarette sales robustness are the US and South Korea, where volume declines in 2020 were minimal. One of the reasons for this is the increased consumption at home, especially during lockdowns. However, the downward trend in cigarettes is here to stay. This will also be strongly affected by declining disposable incomes exacerbated by Covid-19 and the increasing downtrading to economy cigarettes and illicit products. In fact, illicit trade is currently growing at an alarming rate, reaching 12% in 2020, or even 15-16% excluding China. This will remain a key problem in the future especially in fragile markets such as Russia.

There is also the issue of legislation. Covid-19 could establish a new normal for tobacco control, as the pandemic galvanized societies. It is clear that large scale coordinated actions are required to fight the consequences of the pandemic and people are getting united behind the idea that monitoring and controlling of private behavior is ultimately a good thing. This could even increase the voices which want to eliminate the industry altogether.

In light of these disruptors, the demand for new substances will likely increase. As a result, regulatory developments defined by decriminalization and legalization, as well as changing consumer attitudes could provide a huge boost for cannabis. Euromonitor International has predicted that the industry could reach USD 95 billion by 2024 (see Graph 4), which opens new horizons for all tobacco stakeholders, including growers.
DUE DILIGENCE - STRICTER REGULATIONS ARE HERE TO STAY

What is absolutely certain going forward is that even stricter industry-wide regulations will rapidly become the norm all across the world. One of the prime examples of this course is related to due diligence, which represents an ongoing risk management process to continuously identify, prevent, mitigate and communicate how adverse impacts are addressed in supply chains. The impacts could include a wide range of factors such as social and environmental. Due diligence includes key steps with oversight of a governance structure in support of existing policies (see Graph 5 and Graph 6).

Graph 5: Due diligence guidance for responsible business conduct

Source: OECD
Graph 6: Guidance for a 5 step framework for risk-based due diligence

A 5 step framework
1. Establish strong company management systems
2. Identify, assess and prioritize risk in the supply chain
3. Design and implement a strategy to respond to identified risks
4. Verify supply chain due diligence
5. Report on supply chain due diligence

Source: OECD-FAO

In the tobacco context, it is important to note that leading industry players have been working on sustainable production for a long time. There is a lot of discussion about alternative crops, but what is clear is that crop complementation and improving incomes should be the common goal that unites all tobacco growers.

Nowadays, there is an increasing focus on human rights and the environment. This is backed by new regulations and initiatives on political and legislative level addressing supply chain due diligence requirements. Such initiatives are also backed by the UN Secretary General who insists on adding healthy environment as a basic human right. This means increased scrutiny and broad public interest around sourcing (not only tobacco) around the globe. What is more, key targets are not constrained to third world countries but to developments in places like the UK where despite the Modern Slavery Act 2015 seasonal workers in agriculture remain at risk of forced labor even with safeguards to prevent this from happening. Therefore, a holistic approach that includes all aspects of the supply chain will be put in place. Most recently, as reported in ITGA’s Tobacco Monitor January 2021 edition, British American Tobacco published the first industry Human Rights Report highlighting the company’s commitment for zero child labor in its agricultural supply chain by 2025.

There were two strategic moments for increased regulations regarding supply chains - the UN Guiding Principles on Business and Human Rights in 2011 and the Sustainable Development Goals in 2015. Currently, many countries around the world have a national action plan in place around human rights, the environment or broader supply chain due diligence but also hard laws in place which require reporting from companies in addition to imposing penalties, or even sourcing bans in some cases, such as the US tobacco import ban from Malawi, unless certain processes are in place.

Mandatory due diligence laws already exist in France and the Netherlands, while at least a dozen more states are in different stages of implementation. The UK is introducing a new law requiring companies to carry due diligence on key commodities linked to deforestation. Germany officially announced supply chain due diligence law for 2021. The United Nations calls on businesses to use the Guiding Principles to remake their companies when recovering from the Covid-19 pandemic. In 2020, for a very brief peri-
od of time and in the midst of the pandemic, the discussion in the EU progressed from delivering a study to producing a Due Diligence Draft Directive, which is expected to enter into force by mid- to late 2021, with a period to comply within the following 2 years.

As a result, all companies operating within certain thresholds in the EU will have to report on how they conduct supply chain due diligence, require a list of obligations and introduce liabilities. The EU laws will extend to activities of companies and their subsidiaries, therefore encompassing the entire supply chain. The majority of global tobacco manufacturers already have various programs in place, while growers’ awareness and practices are improving. The Sustainable Tobacco Program is undergoing a reform process to put in place risk-based supply chain due diligence in tobacco. It gathers global manufacturers and suppliers around one program, applies to all leaf sourcing countries and aims to stimulate the collaboration between stakeholders from growers to international organizations. Ultimately, we have to remember that these requirements will not go away but continuously increase.
THE CASE OF COLOMBIA: PROBLEMS AND SOLUTIONS

The case of Colombia represents an important cautionary tale for tobacco growers around the world. During the last 15 years tobacco growing was established as one of the main economic activities, generating an important portions of regional revenues.

Since the entry of Coltabaco, an affiliate of Philip Morris International (PMI), and British American Tobacco (BAT) in the market in 2005 and 2011 respectively, tobacco replaced coffee in some of Colombia’s traditional agricultural regions. However, since the peak of production in 2013-2014, that surpassed 10,000 ha, the output has decreased dramatically. As a result, the necessity to find strategic alternatives became a key growers’ concern. To add to the local farmers’ hardships, PMI’s affiliate and BAT announced abrupt factory closures and termination of contract renewals, adding extra pressure on the already struggling sector. To illustrate the losses, PMI’s exit affected 1,340 families with a value impact of USD 4 million. BAT’s exit affected 641 tobacco-producing families with an economic impact of USD 3.5 million. Even though compensation programs were put in place, the short notice leaves growers in an extremely volatile position.

Since then, ITGA has been working closely with the National Federation of Tobacco Producers (FEDETABACO), our local member, in designing an integrated project to find new alternatives for the area that is now left unplanted. The project is aligned with UN’s Sustainable Development Goals (SDGs) by taking into account environmental sustainability, women empowerment, gender equality, youth development and rural finance. It characterizes one of the best examples to date how such problems can be solved together in a sustainable way (see Graph 7). The news of Alliance One leaving Uganda on a short notice shows once again that similar initiatives could play a central role in helping solve difficult problems.
It is now clear that the disruptive events of 2020 will continue to shape the global business environment for the foreseeable future. COP9, the evolving regulatory framework, the emergence of cannabis and other next generation tobacco products, together with the falling cigarette consumption will be the key determinants for the sector’s path forward. ITGA’s commitment to play a leading role in supporting tobacco growers stays firmly in place. In this challenging environment it is more important than ever to stick together and fight for a better future regardless of the difficulties we face.