

# THE CUBAN CIGAR INDUSTRY AS THE TRANSITION APPROACHES

Joseph M. Perry, Louis A. Woods, Stephen L. Shapiro, and Jeffrey W. Steagall

For many decades, premium Cuban cigars have served as the world standard against which other cigars are judged. The story is told that, immediately before President John F. Kennedy approved the embargo against Cuba in 1962, he sent an assistant to Washington tobacco shops to buy up the available supply of the hand-made Cuban cigars that he preferred. Since that time, Cuban cigars have been conspicuously absent from the shelves of retailers in the United States. The Cuban tobacco and cigar industries, however, have adjusted to changing market conditions, and now serve as an expanding source of foreign exchange at a time when the Cuban sugar industry has fallen on hard times.

World-wide cigar production and consumption declined from a relative peak in the mid-1960s until the early 1990s. At that time, consumers rediscovered large, premium cigars. The demand for these high-priced products began to increase, and has yet to reach a peak, according to some industry analysts.

The Cuban hand-made cigar industry has responded to this burgeoning demand by training new rollers and expanding its production for export. Cuba's position in the international cigar market is complicated by the fact that U. S. citizens may not normally buy or possess cigars produced in Cuba. Cigar output from Cuba therefore affects the worldwide cigar market, but impinges on U. S. production and consumption primarily through smuggling.

This paper briefly delineates the international cigar market, examines Cuba's position in the premium

segment of that market, considers the cigar boom in the United States, and makes some suggestions concerning near-term trends, especially if some transitional changes occur in the Cuban economy.

## THE INTERNATIONAL CIGAR MARKET

Cigars are tobacco products that originated in the New World. First identified by Columbus in 1492, they were adopted, along with pipe smoking, by consumers around the world (Ortiz, 1947, pp. 72-73). Cigars are rolls of tobacco wrapped within a tobacco leaf, all of which is consumed as the cigar is smoked. Cigars that are produced today fall into three categories: cigarillos, which are small, slender cylinders of tobacco (cigarettes in a tobacco wrapper are often included in this group); cheroots, which are cigars cut square at both ends; and cigars proper, which are usually cut square on one end. From the point of view of the U.S. Federal government, which taxes their production and sale, cigars are classified as small (weighing no more than three pounds per thousand) and large (weighing more than three pounds per thousand) (USCFR, 1998).

Within the large cigar category are found almost all of the premium, hand-rolled cigars that are so favored by smokers today. These cigars consist of a filler of one or more types of tobacco, held together and shaped by a binder of tobacco, and wrapped in a carefully-chosen tobacco leaf. At retail, premium cigars today will typically sell for \$7.50 to more than \$25.00 each. Although concrete sales data are not available, it is likely that some premium Cuban cigars

smuggled into the United States sell for substantially higher prices (Morrow, 1996).

The size of the international cigar market is not known exactly. Various tobacco trade organizations collect data on production and consumption, but do not have a complete accounting from all countries and all producers. Data from the Tobacco Merchants Association, the primary data-collecting organization in the United States, suggest that the world production of cigars in all sizes is about 14 billion pieces per year.

The major cigar producing countries around the globe generally keep close track of cigar production and estimate levels of consumption, since tobacco growing is often regulated, and tobacco products are frequently taxed. In the United States, for example, the Bureau of Alcohol, Tobacco, and Firearms, in the Department of the Treasury, maintains monthly running balances of the production of tobacco products, removals, imports, and exports. Since the major producing countries account for a large percentage of total cigar output, the only figures really in doubt are those from smaller countries.

**Table 1. Top Ten Producers of Cigars (All Sizes), 1994-1996, Millions**

Country	1996	1995	1994
United States	4,048	3,488	3,327
Belgium	2,246	2,146	2,052
Netherlands	1,801	1,713	1,835
Germany	1,364	1,173	1,300
United Kingdom	975	977	978
Spain	704	675	851
Denmark	334	349	n/a
Switzerland	178	177	n/a
Dominican Rep.	150	101	n/a
Finland	55	53	n/a
Totals:	11,855	10,852	10,143

Source: Cigar Association of America, June, 1998

Table 1 presents data showing the output of the world's top ten producers of cigars over the 1994-1996 period. As the figures indicate, world production is dominated by a handful of countries. Given that world production is about 14 billion cigars, the top six countries in the table account for 80 percent of that total.

Table 2 shows the top ten countries, ranked by the consumption of cigars over the 1994-1996 period. Consumption levels are the net result of domestic production (or removals from storage) minus exports plus imports. The list includes almost the same countries as in Table 1, except that Sweden replaces the Dominican Republic.

**Table 2. Top Ten Consumers of Cigars (All Sizes), 1994-1996, Millions**

Country	1996	1995	1994
United States	4,303	3,642	3,428
Germany	1,469	1,298	1,377
United Kingdom	1,150	1,158	1,165
Spain	755	738	706
Belgium	591	608	827
Netherlands	316	248	471
Switzerland	210	211	213
Denmark	180	202	n/a
Sweden	81	90	n/a
Finland	65	64	n/a
Totals:	9,129	8,259	8,187

Source: Cigar Association of America, June, 1998

A comparison of the figures in Tables 1 and 2 shows that the largest producers of cigars are also major international cigar traders. The United States market, for example, consumed 255 million more cigars than it produced in 1996. It both exported and imported large quantities of cigars. This pattern reflects a broad market, with diverse tastes, and a preference for variety. Germany, the United Kingdom, and Spain were also net importers of cigars. In contrast, Belgium and the Netherlands, long-time producers of tobacco products, were net exporters of cigars.

The data also confirm the dominance of the United States market for cigars. Both production and consumption figures for the U.S. are currently estimated to be between 4 and 5 billion cigars annually, which constitutes between 29 and 36 percent of the world market.

Worldwide cigar production and consumption showed a marked decline for at least three decades, before turning up again in the mid-1990's. In the major producing countries, output reached a peak in the mid-1960's. The 1964 *Surgeon General's Report on Smoking and Health* produced a momentary cigar

**Table 3. Sales of Cigars and Cigarillos in U. S. And Main European Union Markets, 1970-1996, Millions of Units**

Country	1996	1995	1990	1985	1980	1975	1970
United States	4,587	4,040	3,554	4,335	5,374	8,645	8,881
France	1,531	1,460	1,475	1,749	1,927	1,543	972
Germany	1,424	1,314	1,291	1,639	2,155	2,553	3,213
United Kingdom	1,095	1,070	1,490	1,420	1,715	1,800	1,190
Spain	709	693	729	824	904	1,098	561
Belgium/Luxembourg	591	608	673	839	1,013	1,168	1,014
Holland	n/a	455	487	677	902	1,200	1,112
Denmark	190	202	328	474	733	909	1,074
Italy	174	180	210	185	178	200	234
Sweden	81	90	134	111	155	250	326

Source: Cigar Association of America, Inc., June, 1998.

boom in the United States, with U. S. cigar production alone reaching a peak of 8.7 billion units in that landmark year. Thereafter, the decline in output becomes pronounced.

World production, which was down to about 14.3 billion units in 1988, continued trending downward until 1993, when it dropped below 14 billion cigars. Incomplete data from the Tobacco Merchants Association suggest a low of 13.7 billion. From that time until the present, however, both cigar production and consumption have enjoyed a moderate upsurge.

The data in Table 3 verify the rise in cigar usage in the major consuming countries. U. S. cigar sales, including imports, reached a peak of 8.9 billion in 1970, then fell by more than 50 percent through 1990. 1996 sales levels were 29 percent higher. Germany showed essentially the same pattern, while France and the United Kingdom experienced a slightly later peak in consumption.

The reasons for the expansion are still not fully analyzed. A strongly increased demand for premium cigars, especially in countries such as the United States, is clearly one of the forces at work. Advertisements in the popular press in this country show celebrities such as Bruce Willis, Arnold Schwarzenegger, Jack Nicholson, and even Demi Moore enjoying expensive, hand-rolled cigars. Cigar rooms have been established at major restaurants. And specialty shops have installed walk-in humidors to satisfy the demand.

Importers of premium cigars have placed pressure upon producers in countries such as the Dominican Republic and Honduras to meet the growing demand. One may speculate that several years of very strong economic growth, with rising disposable income, may have contributed to the U. S. increase through a wealth effect.

A stronger international market has also stimulated some recent structural changes in cigar production. For example, Tabacalera S.A., Spain's most important manufacturer and distributor of tobacco products, has moved to expand its share of the international cigar market. In late 1997, the firm purchased Tabacalera San Cristóbal de Honduras S.A., and Tabacalera San Cristóbal de Nicaragua S.A., two key Central American tobacco firms which together produce 24 million premium cigars annually. It also acquired the assets of the cigar division of long-established Havatampa, Inc., of Tampa, Florida. The total acquisition bring Tabacalera's share of the world cigar market from an estimated 3.5 percent to a much healthier 10.8 percent. The Havatampa acquisition is especially significant, since that company's two factories produce 1.3 billion cigars per year (Escarey, 1997).

The United States embargo against Cuba has exerted a significant effect on the cigar production in the Caribbean. When Castro came to power, the Dominican Republic produced and exported tobacco, but had only an embryonic cigar industry. Today, the Dominican Republic is one of the world's largest producers of premium, hand-rolled cigars. Cuban ex-

patriates and other entrepreneurs, losing access to Cuba's prime growing regions, saw the opportunity to relocate tobacco production to the nearby island. The Cibao River valley, near Santiago, offered suitable soil and climate. Using Cuban seed in many instances, growers produced tobacco that was similar to the same varieties grown in Cuba. Cigar factories were built, rollers were trained, and the industry was under way. Familiar brands such as Cohiba and Montecristo began to appear with Dominican provenance. Exports to the United States rose from 5 million in 1976, to 33 million in 1981, and to 52 million in 1990, when Dominican cigars enjoyed about 47 percent of the U. S. premium market.

Cigar exports from the Dominican Republic were expected to reach 162 million in 1997, with a value of US\$210 million. 1996 revenues were US\$130 million. The bulk of the exports were premium cigars. Hendrik Kelner, president of Tabacos Dominicanos S. A., indicated that the high rate of growth in the Dominican cigar industry could not last, and would slow to 10 to 15 percent in 1998, as the international market stabilized (DR Economic News, November 13-18, 1997).

The embargo has stimulated cigar production in Honduras, Nicaragua, and Jamaica, which also enjoy the lack of Cuban competition in the United States. Honduran cigar output has remained fairly stable over the past decade, and has now been surpassed by that of the Dominican Republic. Mexico and Costa Rica also produce cigars in this hemisphere.

### TOBACCO AND CIGARS IN CUBA

As Fernando Ortiz (1947, p. 7) pointed out in rather emphatic prose, tobacco and sugar "both flourish in Cuba and are both perfectly adapted, climatically and ecologically, to the country. . . Cuba has in its different zones the best land for the cultivation of both plants. And the same happens in the combinations of the climate with the chemistry of the soil."

The Vuelta Abajo region, in particular, has the ideal combination of light, gravelly soil, humidity, and rainfall to grow the world's finest cigar wrapper leaf (Lestina, 1940b; Dambaugh, 1956).

Tobacco production in Cuba takes place in about 25 named districts (*distritos tabacaleros*), located within four major geographic zones: Vuelta Abajo and Semivuelta, located in Pinar del Río province; Partido, located primarily in Havana, but crossing over into Pinar del Río; the Remedios, located in Santa Clara and Camagüey provinces; and Oriente, in Oriente province. The latter two zones are often collectively termed the Vuelta Arriba (Stout, 1997, pp. 30-31).

Tobacco culture and cigar usage in Cuba go back to pre-Columbian times when the native Americans in many parts of Latin America smoked rolled-up tobacco leaves. Once European settlements became common on the island, first sugar, and then tobacco were institutionalized as cash crops.

As Ortiz points out (1947, pp. 286-289), the tobacco trade in Cuba was taken over by the Spanish government 1557. As would be expected, government intervention resulted in a vigorous trade in smuggled tobacco. The illicit sales of Cuban tobacco and cigars became so troublesome that the Spanish crown forbade the growing of tobacco in Cuba between 1606 and 1614. The royal proscription was ignored by the Cuban tobacco growers, who continued to send their leaf and products abroad. By the 1760's, the Havana type of cigar was being used in England. German production of cigars using Havana leaf began in 1788. And it is said that U. S. production of Havana leaf cigars started between 1801 and 1810. By 1797, large-scale commercial production of cigars was occurring in and around the city of Havana itself. (Ortiz, 1947, p. 286-289, 301-309; Baer, 1933, p. 63).

For many years, the tobacco trade remained a royal monopoly. Following the mercantilistic reasoning of the time, tobacco sales and resales were manipulated by the government for its own benefit. In 1820, the crown finally permitted Cuba to export cigars to countries other than Spain, thus creating the international market for Cuban cigars (Stout, 1997, pp. 12-13).

Over the years, premium Havana cigars established a worldwide reputation for excellence. They dominated the high-quality markets during the nineteenth

**Table 4. Exports of Cigars and Cheroots from Cuba, 1975-1989, in Pounds and in Thousands of US Dollars**

Year	Weight (Lbs.)	Value (US\$K)
1989	61,130	45,260
1988	69,403	53,700
1987	67,583	47,770
1986	59,870	44,987
1985	n/a	51,152
1984	54,512	41,226
1983	n/a	72,241
1982	n/a	63,377
1981	n/a	45,849
1980	n/a	40,552
1979	n/a	41,598
1978	n/a	40,350
1977	n/a	37,707
1976	n/a	43,819
1975	n/a	28,000

**Source:** United Nations, *Yearbook of Inter-national Trade Statistics*, various issues.

century, before cigarettes became accepted socially. They remained the benchmark against which other cigars were measured, even as cigar consumption began to decline after 1920.

When President Kennedy established the trade embargo with Cuba in 1962, smokers in the United States were enjoying about 190 million premium cigars per year. Cuba produced 15 million of that total, or about 9 percent of the market. It also exported almost all of the tobacco that was used to roll the other premium cigars, which were produced in U. S. factories. At that time, the Dominican Republic, Honduras, Jamaica, and Nicaragua produced few cigars (Mendoza, 1997).

Table 4 presents a picture of Cuban cigar exports from 1975 to 1989, before the current cigar boom began. Over a decade and a half, the value of cigar exports fluctuated around an average level of US\$46.5 million. Good harvest years buoyed the figures, while bad harvest years reduced them. It is clear that, while cigar exports generated foreign exchange during this period, they were not a major decision variable in the eyes of the Castro government. While support from the Soviet Union and other Communist Bloc countries continued, and as long as the sugar harvests and nickel prices remained at acceptable levels, cigars

**Table 5. Cuban Unmanufactured Tobacco Exports and Imports, 1990-1996, Metric Tons**

Year	Exports	Imports
1996	5,000	300
1995	5,000	300
1994	4,000	300
1993	3,000	300
1992	7,900	3,201
1991	13,500	300
1990	13,000	1,500
1989	14,491	3,000

**Source:** USDA, *Agricultural Statistics*, various issues.

did not enter importantly into a foreign exchange equation.

After 1990, the breakup of the Soviet Union caused severe economic dislocations in Cuba. The supply of fertilizer, pesticides, and other crop supplies dwindled. The U. S. embargo continued in effect. To top it all off, Hurricane Lili hit Cuba in October 1996, doing damage to cash crops across the island, including tobacco. The figures in Table 5 show how the exports of unmanufactured tobacco were slowed by this complex of factors. Exports dropped by about two-thirds from their 1989 peak. Imports also dropped drastically, at least in part because of the lack of adequate foreign exchange.

In spite of this pessimistic picture, some positive changes have taken place. Tabacalera S.A. came to the rescue of the Cuban cigar industry after the breakup of the Soviet Union generated widespread shortages of fertilizer and pesticides. The Spanish tobacco giant set up a system of credit advances to Cuban cigar producers, in essence lending them the funds to produce cigars, based upon a guaranteed level of cigar exports to Spain ("Cuba on course," 1997). This financial help has made it possible for cigar production to recover somewhat, and to respond to the burgeoning worldwide demand for premium cigars.

Manuel García, vice president of Habanos S. A., the Cuban cigar agency, asserts that the current world demand for premium Cuban cigars lies between 115 and 120 million pieces per year, still greater than the

current level of Cuban production (Darnberger, 1997).

Cuba's current major markets for its premium cigars are located in Europe. Figures from Habanos S. A., indicate that, during 1997, 63 million cigars were exported to Europe. Of this total, 35 million went to Spain, 12 million to France, and 5.5 million to the United Kingdom. Switzerland and Germany are also important markets. About 4.3 million cigars were also exported to the Middle East and to the Pacific region, as those markets began to develop (Darnberger, 1997).

**Table 6. Tobacco Exports from Cuba, by Country of Destination, 1990-1995, Millions of U.S. Dollars**

Country of Destination	1990	1991	1992	1993	1994	1995
France	14	8	6	8	9	10
Germany	4	4	3	3	3	
Netherlands	2	4	5	2	1	1
Spain	42	54	54	40	46	51
Switzerland	8	6	7	6	7	10
United Kingdom	7	6	5	3	3	5
Others	18	18	15	13	11	13
Totals	95	100	95	75	80	90

**Source:** *Cuba: Handbook of Trade Statistics, 1996*. CIA, Directorate of Intelligence.

The data in Table 6 confirm both post-Soviet decline in tobacco exports and their recent recovery. The figures reflect exports of both unmanufactured and manufactured tobacco, and so are indicative of general conditions in the industry. The value of exports hit an estimated US\$100 million in 1991, then dropped by 25 percent by 1993. 1994 and 1995 show some recovery, but not to the previous peak level.

Very recent trends have been more favorable. According to Manuel García, vice president of Habanos S. A., exports of Cuban cigars reached 102 million units in 1997, exceeding the 100 million goal previously set. Previous reported export levels were 50 to 55 million in 1994, and 60 to 70 million in 1995. Foreign exchange revenue from this level of exports was US\$179 million. Production plans are to produce 160 million cigars in 1998, 175 million in

1999, and 200 million in the year 2000, almost all for export. At this point in time, cigars are the fourth most important generator of hard currencies, exceeded only by tourism, sugar, and nickel. Francisco Linares, president of Habanos S. A., speculates that Cuba may be able to produce as many as 400 million premium cigars in the new millennium ("Havanas ready," 1998; Suckling, 1995; Martínez, 1998).

**THE UNITED STATES CIGAR BOOM**

As the figures presented above clearly indicate, the United States dominates the international cigar market in both production and consumption. U. S. smokers consume more cigars annually than smokers in Germany, France, and the United Kingdom combined. Tobacco-use trends in the United States therefore both influence and are reflective of conditions in other major producing countries.

Cigar production and consumption in the United States have shown long cyclical fluctuations. From a low of less than 2 million cigars consumed in 1870, U. S. usage increased to a peak of 8.5 million cigars in 1920. From that point, consumption gradually dropped to 4.6 million in 1933, the trough year of the Great Depression. Once the recovery began, consumption rose above 5 million per year, and, with few exceptions, stayed in the 5 to 6 million range until 1957, when a short, sharp growth trend developed.

The postwar consumption of domestically-produced cigars reached a peak level of 9.1 billion in 1964, and then gradually declined to 2.1 billion in 1993. Since that time, the recent cigar craze has helped to pull both production and consumption up to higher levels (Johnson, 1984, Table 2.1; data from the Cigar Association of America).

The number of U. S. companies producing cigars has shown similar fluctuations. Historical data show that the number of cigar factories in the United States was 15,732 in 1915. From that point until 1982, the number of factories gradually dropped, on an almost straight-line trend. In 1982, only 112 factories produced cigars. Note that these numbers do not accurately reflect the number of cigar companies, since multi-factory companies were becoming more com-

mon (Cigar Association of America data). In 1977, 94 U. S. cigar companies were producing, with 7,700 employees. By 1987, the number of domestic cigar producers was down to 16, with 2,500 employees. In 1992, the last available Census data show 25 cigar companies with 2,600 employees (Bureau of the Census, 1992, Table 1a).

Table 7 shows the production, removal, and estimated consumption of domestic cigars over the 1987-1997 period in the United States. The difference between the production and removal figures is explained by the fact that cigars are usually aged in warehouses for some months after production and that some cigars are exported. The consumption figure reflects the net effect of removals, exports, and imports for each year. Since the last low point in 1991, cigar production in the United States has increased by two-thirds. And since 1993, total cigar consumption has also risen by two-thirds.

**Table 7. Output and Consumption of Cigars, United States, 1987-1997, in Millions of Cigars**

Year	Output	Removals	Consumption
1997	2,900	2,960	3,589
1996	2,430	2,720	3,031
1995	2,040	2,320	2,518
1994	1,916	2,145	2,294
1993	1,795	2,010	2,138
1992	1,741	2,106	2,219
1991	1,740	2,134	2,246
1990	1,896	2,232	2,345
1989	2,010	2,365	2,470
1988	1,980	2,426	2,531
1987	2,133	2,674	2,728

Source: BATF Annual Data

Cigar imports and exports for the same period of time are presented in Table 8. Note that all sizes and types of cigars are included in this accounting. It appears that the worldwide increased taste for cigars affected both the level of cigar imports into the United States, which increased more than fivefold between 1991 and 1997, and exports of U. S. cigars, which rose by more than 30 percent between 1993 and 1997. These figures also underscore a point that was made earlier in the paper: the world's largest economy is also an economy of varied tastes, so that it not

only produces more cigars than any other country on earth, it also exports much of its output, and imports cigars for those consumers who favor foreign brands.

**Table 8. Cigar Imports and Exports, United States, 1987-1997, Millions of Cigars**

Year	Imports	Exports
1997	609	90
1996	320	105
1995	195	94
1994	146	74
1993	127	67
1992	111	76
1991	109	70
1990	111	72
1989	103	78
1988	112	87
1987	113	145

Source: BATF Annual Data.

Cigar and cheroot imports into the United States from the leading Latin American producers, excluding Cuba, for the period 1980-1991, are shown in Table 9. Note that the Dominican Republic gradually moved into a position of dominance, unseating Honduras from first place. According to the Cigar Association of America, the consumption of premium cigars was 97 million in 1991 (Morrow, 1996).

**Table 9. U.S. Imports of Cigars and Cheroots for Consumption, 1980-1991, By Producing Country, Millions of Units**

Country	1980	1985	1991
Dom. Republic	19.8	40.5	49.8
Honduras	31.1	27.2	35.0
Nicaragua	6.2	4.6	1.6
Jamaica	17.6	18.0	7.5
Mexico	12.3	8.0	6.8

Source: USDA, Foreign Agricultural Service

Table 10 provides more detail on patterns of individual cigar consumption in the United States. As data from the Cigar Association of America show, the per capita consumption of large cigars among the total U. S. population dropped to a low of 8 in 1993, then rose to 13 by 1997. By all popular accounts, the figure will be higher in 1998. Among male smokers

only, consumption fell to 25 per capita in 1993, then recovered to 40, a 60 percent increase over a four-year period. Note that the category of “large cigars” includes the premium, hand-rolled types.<sup>s</sup>

**Table 10. U.S. Total and Per Capita Consumption of Large Cigars, 1980-1997**

Year	Annual Consumption (000)	Per Capita Total Population	Consumption Male Population
1997	3,542,161	13	40
1996	3,097,910	12	35
1995	2,631,987	10	30
1994	2,334,870	9	27
1993	2,136,720	8	25
1992	2,211,364	9	26
1991	2,234,204	9	26
1990	2,334,858	9	28
1985	3,110,311	13	40
1980	3,952,478	17	55

Source: Cigar Association of America, June, 1998

Over the past decade, American consumers have annually spent about 2 percent of disposable personal income on cigars. Recorded dollar expenditures on cigars rose from US\$620 million in 1987 to US\$979 million in 1996, an increase of 57.9 percent (USDA, 1997b, Table 29). In 1987, 5.3 percent of adult males in the United States smoked cigars. Those in the 45-64 age group were more likely to be cigar smokers (7 percent). Interestingly, more women are becoming cigar smokers, but in relatively small numbers (CDC, October 13, 1989).

The market for premium cigars has been the driving force behind the overall increase in cigar consumption in the United States. As Table 11 shows, the 1995-1996 increase was substantial.

As the figures in the table also show, the top five producing countries listed dominate the premium cigar market in the United States, accounting for 92.1 percent of sales. The Dominican Republic, alone, provided almost half of the premium cigars sold. Based upon these figures, the imports of premium cigars increased by two thirds between 1995 and 1996. Other analysts suggest a more moderate, but still substantial increase of 32 percent in premium cigar imports, and

**Table 11. Premium Cigars Imported into the United States, By Country of Origin, in Millions of Cigars**

Source	1995	1996	Percent Change	Market Share
Dom. Rep	81.1	138.6	70.9%	47.2%
Honduras	53.5	83.7	56.6	28.5
Nicaragua	3.5	18.0	411.7	6.1
Jamaica	15.3	15.5	1.3	5.3
Mexico	9.7	14.5	49.5	4.9
Total, Top 5	163.1	270.4	65.8	92.1
Others	13.2	23.4	77.0	7.9
Grand total	176.3	293.7	66.6	100.0

Source: Cigar Insider, Cigar Aficionado.

a rise of 42 percent in large cigars in general (Mendoza, 1997).

The U. S. Department of Agriculture (USDA) tracks general trends in tobacco production and use. According to USDA data, the consumption of cigars of all kinds in the United States rose by 16 percent in 1997. Government analysts predicted a continuation of the growth trend through 1998 (USDA, 1998).

**CIGARS AND THE CUBAN ECONOMY TODAY**

The Reuters news agency reported on June 13, 1998, that Cuba is once again facing a very tense economic situation because of adverse conditions in three of its key export industries. The 1997-1998 sugar *zafra* is reported to be at a low of 3.2 million metric tons, 20 percent below the meager harvest of last year. In addition, sugar prices have dropped on international markets. Nickel prices have also moderated, reducing the foreign exchange yield from that important export. Government policy-makers appear to be pinning their hopes on a growing tourist sector, expanding cigar exports, and higher seafood exports (“Cuba’s economic situation,” 1998). There must also be some unexpressed hope that remittances from Cuban expatriates will continue at a high level.

Vice President Carlos Lage puts a brave face on the situation, arguing that Gross Domestic Product will show an increase in 1998 in the 2.5 to 3 percent range, perhaps exceeding the 2.5 percent growth rate of 1997. On balance, the increase in tourist expenditures and the higher level of cigar exports seem to be

two major factors keeping the Cuban economy out of decline. (Tamayo, 1998).

In 1996, an English distributor estimated that the world-wide demand for Cuban cigars was at an annual level of 100 million, causing spot shortages and higher prices in many countries. Ana López, head of marketing for Habanos S.A., stated recently that world demand for Cuban cigars has risen from 125 million to 130 million per year, and that the cigars are now sold in over 80 countries. Smuggled Cuban cigars do reach smokers in the United States. The number is still uncertain, but American cigar manufacturers estimate that they lose from US\$50 to US\$75 million in revenues each year from lost sales. The number of smuggled cigars is variously estimated at 4 to 10 million per year (Morrow, 1996; Oramas, 1997).

#### NEAR TERM PROSPECTS

From a world wide point of view, the recent expansion of the Cuban cigar industry has not had overwhelming impacts upon the market. The worldwide consumption of all cigars is now about 14 billion. An increase in output from 100 million to 167 million *habanos* — or even 200 million — is therefore a minuscule change, about seven-tenths of one percent of the total market supply. It would exert no perceptible influence on average cigar prices worldwide, particularly since the international market has been experiencing an expansion.

Any price effects would be found in the sub market for premium cigars. In the United States, prices for smuggled Cuban cigars would continue to be higher than open-market prices in other countries as long as the demand for them remains strong. In other markets, where *habanos* are sold legally, prices will remain strong as long as Cuban supply lags increases in demand, and as long as demand does not peak and begin to fall.

According to available data and observations by Cuban cigar industry officials, the demand for premium Cuban cigars in other countries apparently has not peaked. In the 80 countries now importing Cuban cigars, more could be sold than are now placed on the market. Cuban officials are also looking at other

markets, including the Near East and the Pacific region, where Cuban cigars now have a foothold. Expansion is possible up to some limiting level, where natural resources in Cuba and conditions in the market place dictate a ceiling.

Resource constraints in Cuba are obvious. Although the island is the largest in the Caribbean, good tobacco land is limited. There is only one Pinar del Río area, and it is being intensively exploited. Other tobacco-growing areas can be pushed only so far. At the point where leaf production is maximized (or optimized), cigar production also reaches a maximum. The only alternative would then be to import leaf to make cigars, thus violating one of the five legal characteristics of an *habano*: that all of the tobacco in the cigar must be grown in Cuba (Stout, 1997, pp. 9-10).

Following this line of reasoning, it may be said that prime tobacco land in the Dominican Republic is similarly limited. Once the suitable areas in the Cibao River Valley and around Santiago are placed in cultivation, a ceiling on output is effectively reached. In both Cuba and the Dominican Republic, moving to less desirable lands will lower the quality of the tobacco, dropping its quality to a level with that of less desirable tobaccos grown in other countries. In other words, the uniqueness of the soil endowment limits premium cigar production.

Pre-transition then, a continuation of present output trends seems likely, with both Cuban and non-Cuban premium cigars enjoying an expanding market for at least one or two more years, perhaps longer.

Interestingly, the recent cigar boom has followed a pattern similar to that of the life cycle of a product. There was an initial strong surge of interest in and consumption of premium cigars, much like the initial introduction of a successful product, when output increases at an increasing rate. After hitting an inflection point, cigar consumption rose more slowly, at a decreasing rate. As far as may be determined, the submarket for top-end cigars is still expanding. The critical question is: When will it reach a peak (essentially a market saturation point), and perhaps be poised for a decline?

As noted above, a booming U. S. economy, low levels of unemployment, and high levels of disposable personal income may be necessary, but not sufficient, factors behind the cigar boom. Since 1993, real disposable personal income has followed a clearly upward trend, spiking once in 1995. U.S. real Gross Domestic Product has also grown at healthy annual rates: 3.5 percent in 1994, 2.5 percent in 1995, 2.0 percent in 1996, and 3.8 percent in 1997. Estimated real growth during the first quarter of 1998 exceeds 4 percent. (FRB St. Louis, June, 1998). Such robust growth has pushed the national unemployment rate to around 4.5 percent, well below the “natural rate” level identified by many economists.

In addition to the robust economic growth that has buoyed disposable income, there have been substantial wealth effects at the same time. Over the past four years, stock values on U. S. markets have risen by about 28 percent per year. At the same time, stock values in European markets have been rising at about 5 to 6 percent per year. Given an upward trend in both wealth and income, higher levels of luxury good consumption, such as premium cigars, is to be expected. Note, too, that cigar consumption in the United States is most common among males who are 45 to 64 years old, or who are normally in their highest earning years.

If the U.S. embargo continues, it is likely that the current trends in premium cigar production will continue until the boom peaks, or until there is an economic downturn. Continuing strong economic growth in the United States could encourage further expansion in Caribbean cigar production, particularly in the Dominican Republic. Recent efforts by the U. S. Customs Service to reduce the smuggling of Cuban cigars into the United States suggest that illicit *habanos* might decline in numbers.

If the transition to a market economy takes place, with the consequent elimination of the U.S. trade embargo, or if the embargo is dropped for other reasons while the Castro administration is still in power, then other changes may be expected.

One critical question has to do with trade policy in a more liberal international environment. Will the

Castro government (or its successor) encourage the immediate development of the U.S. market for cigars? Cuban cigar producers cannot now satisfy the world demand for their products. If the world demand remains strong, or expands, then entry into the U.S. market would take place at the expense of other markets that are now being serviced around the world. Habanos S.A. officials articulate the position that they will continue to supply the markets in which they now have a strong position., even if the U.S. embargo is lifted.

If U.S. smokers could legally buy Cuban cigars, but they were not directly supplied from Cuba, then the expression of their demand could result in re-exports from countries other than Cuba, and a rise in premium cigar prices.

The opening of the U.S. market to Cuban cigars would also jeopardize the position of the cigar industries in the Dominican Republic and Honduras, which depend critically upon U.S. demand for their growth. As pointed out above, the U.S. trade embargo has been a primary reason behind the expansion of the Dominican industry, which has a protected market in the United States. The extent to which Dominican or Honduran cigars would substitute for Cuban premium cigars is impossible to determine, without some kind of market test. There would clearly be a substitution effect, once Cuban cigars were available from standard retail establishments.

One post-transition possibility is that not only Cuban cigars, but also Cuban tobacco could once more be exported to the United States. If appropriate fillers, binders, and wrappers could be put together, then cigar factories in the United States could produce cigars that would be competitive with those coming from Cuba, similar to the situation that existed in 1959. Cuban trade policies would clearly influence such a trend.

And what about the future consumption of cigars? Since the mid-1960s, the world-wide use of cigars has followed a generally declining trend. How long will the current boom last? Since both Cuba and the Dominican Republic are continuing to expand their

productive capacity for premium cigars, is overproduction a near-term possibility?

It is clear that the future of the Cuban cigar industry depends upon a complex of factors, many of them impossible to assess at themoment. The near-term expansion of the industry will be largely determined by world economic conditions, in particular the strength of the U.S. economy. Given current eco-

nomie indicators, a continuation of existing trends for Cuban cigars appears likely.

A longer-term analysis will require more detailed information, and needs to be based upon more rigorous analysis. As additional data are collected, this initial essay will be extended through some formal modeling of the international and U.S. cigar markets, to generate results that are technically more satisfactory.

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