

CRS Report for Congress

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Tobacco-Related Programs and Activities of the U.S. Department of Agriculture: Operation and Cost

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Summary

The U.S. Department of Agriculture (USDA) has long operated programs that directly assist farmers and others with the production and marketing of numerous crops, including tobacco. In most cases, the programs themselves are not controversial. Increasingly, however, where tobacco is involved, the use of federal funds is being called into question. Taken together, all of the directly tobacco-related activities of the USDA generated net expenditures of an estimated \$85.8 million in FY2004, and the budget anticipates net revenues of \$32.6 million for FY2005.

The federally financed tobacco price support program is the major form of tobacco farmer assistance, which recently has been supplemented with quota loss payments and the acquisition of surplus tobacco inventories. The USDA is prohibited by language in the annual appropriations law from spending funds to help promote tobacco exports and to conduct research relating to production, processing, or marketing of tobacco and tobacco products. Other tobacco-related activities have been subjected to congressional scrutiny. The USDA does operate numerous programs that are not tobacco-specific, but are available to farmers that produce tobacco and other crops. These are not examined in this report.

Price Support Program

Marketing Quotas and Loans

The tobacco price support program is designed to raise and stabilize farm tobacco prices at a higher level than they would be otherwise. This is accomplished through a combination of two program features, marketing quotas and nonrecourse commodity loans.

The national marketing quota is the amount of tobacco judged sufficient to meet annual domestic and export demand, but at a price at least as high as the legally mandated

support price. In other words, the production of tobacco is held below what it would otherwise be. By restricting production, farm income is supported through artificially higher market prices, causing buyers of tobacco (and ultimately the consumers) to bear the cost of the price support program.

In conjunction with marketing quotas, minimum selling prices are guaranteed to farmers through Commodity Credit Corporation (CCC) nonrecourse tobacco loans. At the auction sale barn, each lot of tobacco goes to the highest bidder, unless that bid does not exceed the government's loan price. In such a case, the farmer is paid the loan price by a price stabilization cooperative, with money borrowed from the CCC. The tobacco is consigned to the cooperative, which redries, packs, and stores the tobacco as collateral for the money borrowed from the CCC. The cooperative later sells the tobacco, with the proceeds going to repay the CCC — with interest.

Thus, the loan program provides a financing mechanism to store tobacco for long periods of time in order to balance supply with demand. In any given year, the budgetary impact of the loan program is the difference between loan outlays (new loans made) and loan recoveries (old loans repaid). In some years, loan repayments exceed new loan requests, resulting in revenues in excess outlays for the CCC. For FY2005, tobacco price support loan activities are anticipated to result in net revenues of about \$100 million.

No-Net-Cost and Marketing Assessments

Congress passed the No-Net-Cost Tobacco Program Act in 1982 (P.L. 97-218). This law mandates that the tobacco program be carried out at no net cost to taxpayers (other than administrative expenses common to all commodity support programs).

Costs arise when tobacco put under loan is later sold at prices insufficient to cover the loan principal plus accumulated interest. To cover all such losses, the law mandates an assessment on sellers and buyers at the wholesale level on every pound of leaf tobacco marketed. The assessment rate is administratively determined and the revenue is deposited in an off-budget account that is held to reimburse the CCC for any financial losses resulting from tobacco loan operations.

The no-net-cost rule has muted much of the criticism that taxpayers are subsidizing tobacco farmers. However, there is confusion over the appearance of tobacco spending in the budget. The annual budgetary impact of the tobacco loan program is determined primarily by loan outlays (new loans made) and loan recoveries (repayment of old loans). In any given year, new loan outlays may be more or less than old loan repayments. In the FY2005 budget, the sizable net revenue of nearly \$100 million is expected to result from the previously large loan outlays being repaid (\$207.1 million), compared to a modest level of new loan outlays being made (\$107.1 million). Since tobacco is typically stored for extended periods, it can be several years before the loan inventory is sold and debts are settled. In all cases, the law requires that any losses of loan principal and interest be reimbursed from no-net-cost assessments.

However, in 1986 and again in 2000, when accumulated loan inventories threatened the financial solvency of the no-net-cost fund, Congress transferred ownership of the tobacco to the CCC and forgave the no-net-cost requirement. Disposal of these tobacco stocks cost CCC about \$376 million and \$625 million respectively.

Administrative Operations

The tobacco price support program is administered by USDA's Farm Service Agency (FSA). Annual administrative costs are budgeted at about \$25 million in FY2005 for tobacco price support operations. This cost covers primarily salaries for the staff time devoted to the tobacco program in about 600 county offices. Critics point out that this administrative cost falls upon taxpayers, thus undermining the no-net-cost claims of program supporters.

A more detailed explanation of the tobacco price support program is found in Tobacco Price Support: An Overview of the Program, CRS Report 95-129. The Farm Service Agency provides detailed *Program Fact Sheets* for flue-cured, burley and other types of tobacco.

Quota Loss Payments and Disaster Assistance. In response to low commodity prices in 1999, Congress authorized market loss payments to producers of grains, cotton, oilseeds, tobacco, dairy, and peanuts in FY2000. \$328 million was specified for tobacco growers. The funds were distributed as direct payments from CCC to tobacco producers in proportion to the amount each grower's quota was reduced in 1999 from the previous year. An additional \$2.8 million was paid as compensation for flood-damaged tobacco on auction warehouse floors. Subsequently, Congress approved additional direct payments to tobacco growers of \$350 million and \$129 million in FY2001 (with a small amount of the payments carrying into FY2002), and \$51 million in FY2003. No similar quota loss payments were made in FY2004 or are anticipated in the FY2005 budget. (Detailed information is in CRS Report RS20802, *Tobacco Farmer Assistance*).

Federal Crop Insurance

The federal crop insurance program, administered by USDA's Risk Management Agency, provides farmers with subsidized multi-peril insurance on tobacco and other crops. The insurance covers unavoidable production losses due to adverse weather, insect infestations, plant diseases, and other natural calamities. It does not cover avoidable losses caused by neglect or poor farming practices. Sales and servicing of policies are done by private companies with some federal reimbursement, and most of the net indemnity losses fall upon the government. Additionally, the premiums have been subsidized since 1980 in order to encourage participation and avoid enactment of *ad hoc* disaster assistance programs. Experimental Crop Revenue Coverage, available for wheat, corn, and soybeans, is not available for tobacco.

Total net federal expenditures for tobacco crop insurance coverage include outlays for crop loss indemnity payments, plus the premium subsidies, plus sales administrative expenses, less the farmer-paid premiums. Net federal outlays are estimated to be \$39.9 million in FY2004, and are budgeted at \$41 million for FY2005.

Tobacco Inspection and Grading

The USDA's Agricultural Marketing Service (AMS) carries out inspection and grading services at tobacco auction markets and import terminals. The establishment of uniform standards of quality, with grading by unbiased experts, helps assure that auction markets perform efficiently and fairly. Federal grading also provides an assurance of quality for tobacco held as collateral for CCC price support loans. Additionally, imported and domestic tobacco is inspected to guard against illegal pesticide residues. Since 1981, the inspection and grading services have been financed through user fees (now set at \$0.90 per 100 pounds for domestic tobacco and \$0.45 per 100 pounds for imported tobacco). These fees are sufficient to fully cover the costs of inspection activities as well as the cost of developing and maintaining the standards applied by the inspectors.

Market News Services

The Agricultural Marketing Service provides a market news service for sellers and buyers of tobacco. Daily reports of grades, prices, and sales volume at the auction markets are distributed throughout the tobacco industry. The cost of the tobacco news service in FY2005 is budgeted at \$719,000. Similar market news services are provided for all major agricultural commodities. Market news services are designed to provide farmers, and others in the marketing chain, with timely, accurate, and unbiased information on market conditions, to help them make better decisions on where and when to sell and buy commodities. According to economists, such information is necessary for a market economy to function efficiently and effectively. In the absence of a taxpayer-funded market news service, the information might be collected and sold by commercial enterprises, but questions of bias could arise.

Tobacco Research

In the past, USDA-funded research related to tobacco production, processing, and marketing. Some of the research was carried out by Agriculture Research Service (ARS) scientists and some was done by university scientists funded through the Cooperative State Research, Education, and Extension Service (CSREES). Annual research spending by the USDA averaged about \$6.6 million until it was terminated under the FY1995 agricultural appropriations law and subsequent laws. The restriction does not apply to research on medical, biotechnological, food, and industrial uses of tobacco. A special research grant of \$320,000 was approved for FY2004 to investigate alternative uses of tobacco plant material. No similar spending is anticipated in FY2005.

Extension Education

The jointly funded federal-state-county extension education and technical assistance program is designed to serve as a link between the nation's agricultural research institutions and farmers. The term extension conveys the concept of extending the work of researchers into the community. At the county level, extension agents distribute information and expert advice to farmers and others through published materials, seminars, and direct consultation. The state extension staff, given their close proximity to researchers, continuously trains the county agents and designs and prepares materials

for use by the county agents. In FY1997, CSREES spent \$680,000 on tobacco-related extension activities. Federal funding was eliminated in FY1998 by the Administration and remains at zero. All state and county extension activity related to tobacco is funded by the states.

Economic Analysis

The Economic Research Service (ERS) is responsible for assembling and analyzing economic data and forecasting market data within the USDA. As with the other major commodities, ERS assembles and analyzes supply and demand data on tobacco. ERS periodically publishes analytical findings in a Tobacco Situation and Outlook Report. Economists also conduct studies on related topics, such as the structural characteristics of tobacco farming, the role of tobacco in local economies, and the likely impact of program changes and policy options. ERS spending on tobacco analysis during FY2005 is budgeted at \$120,000.

International Data Collection and Analysis

The Foreign Agriculture Service (FAS), through its network of agricultural counselors and attaches, collects economic intelligence throughout the world. This intelligence is used by trade negotiators, economists, policymakers, and the business community. Tobacco is one in a long list of commodities on which the FAS staff collects information. The USDA estimates that the cost of this effort for tobacco will be \$190,000 in FY2005.

Domestic Crop Data Collection

The National Agricultural Statistics Service (NASS) collects field-level data on planting intentions, crop conditions, harvesting progress, yield, and production. This information helps the business community, including farmers develop marketing plans. Also, it serves to alert policy officials of likely shortages or surpluses, thereby facilitating plans for any government action that might be taken. The information that NASS compiles and distributes is considered by economists to be critical to an efficiently functioning market economy. It is argued that the absence of NASS data would most severely disadvantage farmers and government officials, who are least able to obtain information through alternative sources. Tobacco is one in a long list of commodities on which NASS staff collects information. The USDA budgeted the cost of this effort for tobacco at \$233,000 in FY2005.

**Table 1. USDA Tobacco-Related Net Budgetary Expenditures,
Estimated FY2004 & Budgeted FY2005**

USDA Agency ▶ Activity or program	FY2004 Estimate \$000	FY2005 Budget \$000
Commodity Credit Corporation/Farm Service Agency		
▶ Administrative expenses of price support — salaries and office expenses of county offices.	24,114	25,010
▶ Tobacco price support loan and related operations — price support program loan outlays, less repayments.	20,155	(99,993)
▶ Direct payments to support tobacco farms.	0	0
Risk Management Agency		
▶ Crop insurance — tobacco crop loss indemnity payments and administrative expenses, less grower premiums.	39,919	41,072
Agricultural Marketing Service		
▶ Market news reporting — collection and dissemination of auction market prices and sales volume data.	708	719
Cooperative State Research, Education, and Extension Service		
▶ Special research grant on alternative uses of tobacco.	320	0
Economic Research Service		
▶ Economic analysis and projections — supply, demand, & trade analysis, and projections related to tobacco	120	120
Foreign Agricultural Service		
▶ World market analysis — collection and analysis of foreign country economic data on tobacco production and trade	187	190
National Agricultural Statistics Service		
▶ Agricultural statistics collection — data collection on U.S. tobacco acreage, crop condition, yield, and production.	230	233
Total USDA net expenditures for tobacco-related activities	85,753	(32,649)

Source: Data are from the USDA's Office of Budget and Program Analysis, Program-By-Program Summary, Estimated Costs Related to Tobacco Activities, May 11, 2004.

Note: Numbers in parentheses are net revenues (i.e., negative net expenditures).