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Tobacco Farmer Assistance

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Summary

Efforts to reduce tobacco consumption in the United States, stimulated by the 1998 Master Settlement Agreement (MSA), contributed to a sharp decline in the demand for U.S.-grown tobacco. The other major contributor to the long term decline in domestic as well as foreign demand was the federal price support program, which limited supply and raised the price of U.S. tobacco above competitive market levels. Consequently, foreign-grown tobacco displaced U.S. tobacco in both domestic and world markets. Because of the drop in demand, farmers asked for and received compensation and assistance from cigarette manufacturers and the federal government. Manufacturers, in conjunction with the MSA, pledged $5.15 billion in payments to farmers to be distributed over 12 years. Also, Congress approved $328 million in tobacco loss payments to farmers for FY2000, $340 million for FY2001, another $129 million for FY2001, and $55 million for FY2003. In addition, losses on 1999 crop price support loan stocks, amounting to $625 million, were shifted to taxpayers. Finally, in 2004, legislation was adopted terminating the tobacco support program, but with compensation to quota owners and active producers of $9.6 billion (paid by manufacturers).

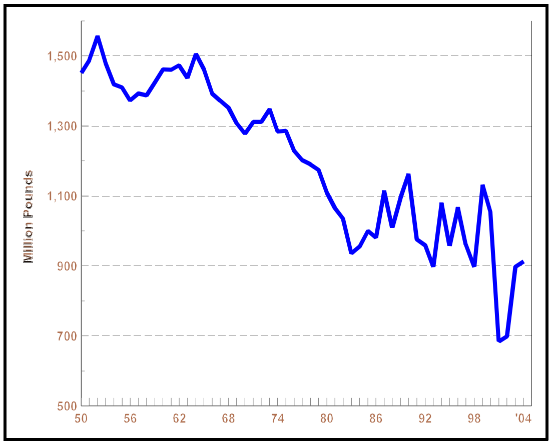
This report will not be updated.

The tobacco price guarantee provided by the federal support program was supposed to support and stabilize the income of growers. However, farmers saw an especially sharp drop in sales volume after 1997. In response, production was reduced 51% by 2004. Like other farmers suffering economic hardship, tobacco growers asked for and received assistance.

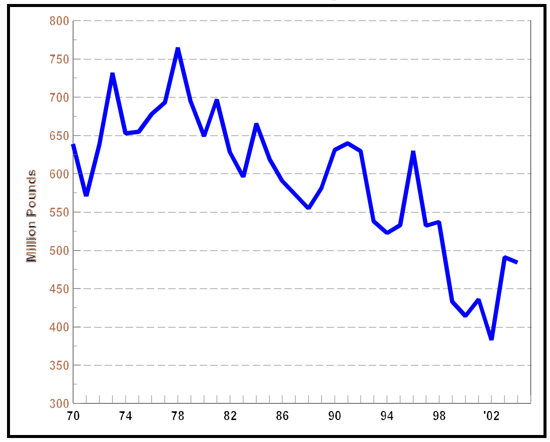
U.S. Tobacco Production and Markets

Based on the 2002 Census of Agriculture, about 57 thousand farms in the United States produce tobacco. They primarily are located in Kentucky, North Carolina, and neighboring states. According to U.S. Department of Agriculture (USDA) data, crop year 2004 production was about 848 million pounds from 408 thousand acres (7.2 acres per farm), for a yield of 2,161 pounds per acre. The average price is estimated at about $1.98 per pound, for a total crop value of about $1.685 billion.[1]

U.S. Leaf Domestic Use



U.S. Leaf Exports



The utilization of U.S. tobacco leaf by domestic cigarette manufacturers and export sales long have been declining. Economists argue that the decline in sales and the loss of market share is due to the high price and tight supply of U.S. tobacco caused by the federal price support program. Other countries increased tobacco production and sales to traditional U.S. markets, including to U.S. manufacturers. In 2004, U.S.-manufactured cigarettes contained about 61% of the cheaper imported tobacco. Additionally, U.S. leaf exports have been on a declining trend for at least the past 20 years (down to about 7.6% of world exports). The disadvantage of U.S. tobacco is illustrated by its average price during 2004 of $2.89 per pound (declared weight) leaving U.S. ports compared to $1.26 for foreign tobacco entering those same ports.[2] The higher quality of U.S. tobacco helped offset some of its price disadvantage, but not enough to prevent the loss of market share.

Adding to the difficulties of tobacco farmers was the declining per capita consumption of cigarettes for at least the past 30 years. It is anticipated U.S. cigarette consumption will continue to decline in future years if the anti-smoking elements of the 1998 Master Settlement Agreement are effective.

Tobacco Price Support

From the 1930s through 2004, tobacco farmers benefitted from a federal price support and stabilization program (see CRS Report 95-129, *Tobacco Price Support: An Overview of the Program*). Federal law specified a guaranteed minimum price for leaf tobacco. The price guarantee was achieved by controlling supply. Each tobacco farm was assigned a marketing quota that balanced national production with domestic and export demand. Any tobacco that did not bring at least the guaranteed price was purchased by a “price stabilization cooperative” with money borrowed from the USDA’s Commodity

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[1] Data on tobacco economics are published by the Economic Research Service in Tobacco Situation and Outlook Reports available at the Tobacco Briefing Room.

[2] Calculated from export and import value data in USDA, Foreign Agriculture Service, Tobacco: World Markets and Trade, January 2004.

Credit Corporation (CCC).[3] The 2004 crop year support price for flue-cured tobacco was $1.690 per pound, and for burley it was $1.873.

By law, the tobacco loan operations of the CCC were to function at no net cost to taxpayers. Price stabilization cooperatives that borrowed money from CCC earned revenue from the sale of tobacco acquired from farmers and this money was used to make repayments with interest. If the revenue from tobacco sales was insufficient to cover the obligations to CCC, funds were withdrawn from a no-net-cost assessment pool. This pool of money was generated from an assessment on every pound of leaf tobacco marketed. The assessment on 2004-crop flue-cured was 10¢ per pound, and on burley it was 2¢.

Federal Purchase and Disposal of Surplus Tobacco

Additional assistance for burley, flue-cured, and cigar binder tobacco producers was included in the FY2001 agriculture appropriations law (P.L. 106-387, Sec. 844, as amended). Tobacco stabilization cooperatives were authorized to transfer ownership of 1999 crop loan inventories to the CCC without the action being charged against the no-net-cost program, and without the supplies being included in future quota calculations. This meant tobacco marketing quotas would be larger in subsequent years than without the legislative action.

The law authorizing the CCC acquisition prohibited the sale of this tobacco for domestic use. The tobacco was offered for export sale at what CCC determined to be its fair market value, but no buyers responded.[4] This left the CCC with little choice but to bury the tobacco in landfills, which it completed in December 2003. The CCC acquired and destroyed 221.4 million pounds of tobacco. Expenditures for this tobacco stocks disposal program (including acquisition costs, interest on funds borrowed from the U.S. Treasury, storage, and disposal) amounted to about $625 million.

The CCC takeover of 1999 loan stocks paralleled action taken in 1986 when 1983-crop burley loan stocks were acquired and disposed of without being charged against the no-net-cost program. On that occasion, the cost to CCC was about $376 million. So, while the tobacco program lived up to its mandate of no net cost to taxpayers, it was because Congress acted to prevent sizeable downward quota adjustments and shifted the financial burden of surplus stocks onto taxpayers instead of producers.

Federal Compensation for Decreased Tobacco Marketing Quotas

Tobacco marketing quotas declined as domestic and export demand dropped. In 1999 and 2000, the quota reductions were especially large and Congress approved additional federal assistance. Direct payments amounted to about $1 for each pound of quota loss. The FY2000 appropriation for USDA (P.L. 106-78, Sec. 803(c)) provided

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[3] The CCC is a financial institution in the USDA that is authorized to borrow money from the U.S. Treasury to carry out commodity support and other farm assistance programs.

[4] The option of reducing the CCC list price was rejected for at least two reasons. First, the law also prohibited the Foreign Agricultural Service from promoting the sale or export of tobacco in overseas markets. Second, selling tobacco at reduced prices in export markets that is prohibited in domestic markets raises questions of legality under international trade rules.

another $328 million in direct "quota loss payments." The law directed that the funds be distributed in proportion to each farm's reduction in marketing quota from 1998 to 1999. The national burley quota had decreased 29% and the flue-cured quota had decreased 18%.

Again, in the Agriculture Risk Protection Act of 2000 (P.L. 106-224, Section 204 (b)), Congress instructed that $340 million be distributed in FY2001 to tobacco farmers. The state-by-state distribution of this money was based largely on quota decreases from crop year 1999 to 2000. The national burley quota had decreased 45% and the flue-cured quota had decreased 19%.

As directed by P.L. 107-25, another $129 million was distributed among tobacco farmers (exactly as done under P.L. 106-224) before October 2001. The addition of this money meant that the decline in flue-cured and burley quotas from 1997 to 2001 was compensated at the rate of $1 per pound.

The consolidated appropriations act for FY2003 (P.L. 108-7) included a provision in the emergency agricultural assistance portion of the law (Division N, Title II, Sec. 205) directing the payment of 5.55¢ per pound of 2002 basic quota. These payments were expected to total about $55 million.

Table 1. Distribution of "Tobacco Quota Payments," by State
(Rounded to nearest $000)

State	P.L. 106-78	P.L. 106-224	P.L. 107-25	P.L. 108-7	State	P.L. 106-78	P.L. 106-224	P.L. 107-25	P.L. 108-7
KY	$123,241	$140,000	$53,118	$13,475	FL	$3,556	$2,500	$949	$714
NC	$99,721	$100,000	$37,941	23,300	MO	$1,719	$2,000	$759	$200
TN	$33,794	$35,000	$13,279	4,100	WV	$1,155	$1,300	$493	$100
VA	$19,501	$19,000	$7,209	3,900	WI	$1,919	$675	$256	$300
SC	$17,836	$15,000	$5,691	4,200	AL	$130	$100	$38	$30
GA	$14,977	$13,000	$4,932	3,600	KS	$20	$23	$9	$2
OH	$5,644	$6,000	$2,276	600	OK	$1	$1	$0	$0
IN	$4,785	$5,400	$2,049	500	AR	$1	$1	$0	$0
					Total	**$328,000**	**$340,000**	**$129,000**	**$55,000**

Phase II, National Tobacco Grower Settlement Trust

The 1998 Master Settlement Agreement between cigarette manufacturers and states' attorneys general obligated the manufactures to pay states approximately $205 billion over 25 years. In addition, the Agreement restricted marketing activities and funded anti-tobacco advertising. An explicit goal was to reduce cigarette consumption. However, any reduction in cigarette consumption indirectly would decrease use of U.S.-grown leaf tobacco, with associated adverse impacts on the financial condition of farmers and their rural communities. Some states designated a portion of their settlement funds for farm and rural assistance.

As an aside and separate from the MSA, manufacturers committed a further $5.15 billion for distribution over 12 years to tobacco farmers under the National Tobacco Grower Settlement Trust agreement (also known as the Phase II settlement). The individual states were responsible for designing the allocation among tobacco farm operators and absentee quota owners. A provision of the agreement provided an offset to Phase II for any future federal charges against manufacturers to help tobacco farmers and quota holders. This offset would be invoked to end Phase II payments in 2004 when manufacturers were assessed to pay for the quota buyout program.

Table 2. Planned Distribution of Phase II Trust Funds, by State and Year

State	Share %	Total payments 1999-2010	Annual Payments, $000				
			1999	2000	2001	2002-08	2009-10
NC	37.95%	$1,954,425	$144,210	$106,260	$151,800	$189,750	$111,953
KY	29.66%	$1,527,490	$112,708	$83,048	$118,640	$148,300	$87,497
TN	7.57%	$389,855	$28,766	$21,196	$30,280	$37,850	$22,332
SC	6.94%	$357,410	$26,372	$19,432	$27,760	$34,700	$20,473
VA	6.58%	$338,870	$25,004	$18,424	$26,320	$32,900	$19,411
GA	5.85%	$301,275	$22,230	$16,380	$23,400	$29,250	$17,258
OH	1.36%	$70,040	$5,168	$3,808	$5,440	$6,800	$4,012
IN	1.16%	$59,740	$4,408	$3,248	$4,640	$5,800	$3,422
FL	1.13%	$58,195	$4,294	$3,164	$4,520	$5,650	$3,334
MD	0.62%	$31,930	$2,356	$1,736	$2,480	$3,100	$1,829
PA	0.43%	$22,145	$1,634	$1,204	$1,720	$2,150	$1,269
MO	0.42%	$21,630	$1,596	$1,176	$1,680	$2,100	$1,239
WV	0.28%	$14,420	$1,064	$784	$1,120	$1,400	$826
AL	0.05%	$2,575	$190	$140	$200	$250	$148
Total	**100.00%**	**$5,150,000**	**$380,000**	**$280,000**	**$400,000**	**$500,000**	**$295,000**

Source: Based on data from General Accounting Office, *Tobacco Settlement: States' Allocations of Phase II Funds*, GAO-03-262R, December 3, 2002, Washington, DC.

Tobacco Quota Buyout and Termination of Support

When Congress attempted to address the economic problems of tobacco farmers, it was faced with economic complexities that were compounded by policy and program inconsistencies and contradictions. In its report of January 26, 2001, the Commission on Improving Economic Opportunity in Communities Dependent on Tobacco Production While Protecting Public Health (commonly referred to as the Tobacco Commission) examined these issues in detail.

It was the policy of the federal government to discourage consumption of cigarettes (especially by young people) on the grounds that they were addictive and harmful to human health. Yet, to the extent Americans reduce their consumption of tobacco products, tobacco farmers were faced with a shrinking market. So, federal public health policy worked to the disadvantage of tobacco farmers. Second, it was federal policy for more than 60 years to balance U.S. tobacco production with demand, but at a price that was substantially higher than the cost of production, and also higher than the price of tobacco sold by foreign producers. To the disadvantage of tobacco producers, the high price of U.S. tobacco caused it to be displaced by less expensive foreign-grown supplies in both this country and worldwide. This displacement was translated into declining marketing quotas.

Congress ultimately made a dramatic change in tobacco policy by terminating all federal price support and management of supplies after crop year 2004 under provisions of the Fair and Equitable Tobacco Reform Act of 2004 (Title VI of P.L. 108-357). Compensation was to be made to both quota owners (landowners) and active producers (farm operators) from assessments on tobacco manufacturers and tobacco importers. The quota owner payments were at the rate of $7 per pound of basic quota on each farm in 2002. The active producer payments were at the rate of $3 per pound on 2002 effective quota. The payments, totaling an estimated $9.6 billion, would be made in equal annual installments over 10 years. Beginning with the 2005 crop, tobacco could be produced by any farmer, in any location, and in any quantity. Prices would be freely negotiated between producers and buyers, and there would be no federal income support for the farmers. This legislation did not alter the availability to tobacco growers of federally subsidized crop insurance, which similarly was available to growers of most crops.

While tobacco manufacturers would be paying for the buyout program, they also would be the direct beneficiaries of an expected reduction in prices for U.S. produced leaf. In addition, the remaining Phase II payments of about $3 billion ended in 2004 because the buyout legislation imposed assessments on manufacturers beginning in the last quarter of calendar 2004.

For More Information

- CRS Report RS22046, *Tobacco Quota Buyout*.
- CRS Report RL31790, *Tobacco Quota Buyout Proposals in the 108th Congress*.