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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.

Since 1982, the tobacco price support program has been under a statutory mandate to operate at no net cost to the federal government. More recently, Congress has prohibited the USDA from spending funds to help promote tobacco exports and to conduct research relating to production, processing, or marketing of tobacco and tobacco products. Subsequent appropriations laws have sustained these prohibitions. Other tobacco-related activities have been subjected to congressional scrutiny.

Taken together, all of the directly tobacco-related activities of the USDA generated net expenditures of an estimated $343 million in FY1998, and are budgeted at $8 million in FY1999. The net expenditures result from price support loan outlays exceeding repayments and deficit reduction assessments. The USDA does operate other 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 recent years, loan repayments have exceeded new loan requests, resulting in revenues in excess outlays for the CCC. However, for FY1999, the loan activities are budgeted to result in net expenditures of $317 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 a price insufficient to cover the loan principal plus accumulated interest. To cover all such loses, 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 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 FY1999 budget, the sizable net revenue of nearly $129 million is expected to result from the previously large loan outlays being repaid compared to a modest level of new loan outlays being made. 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.

The tobacco program, like most other commodity price support programs, is subject to deficit reduction requirements authorized by the Omnibus Budget Reconciliation Acts of 1990 (P.L. 101-508) and 1993 (P.L. 103-66). A marketing assessment of 1% of the support price is collected on every pound of leaf tobacco marketed. This deficit reduction assessment (with the revenue going toward general deficit reduction and not the tobacco program) is budgeted to generate about $32 million in FY1999.

Administrative Operations

The tobacco price support program is administered by USDA's Farm Service Agency (FSA). Annual administrative costs are budgeted at about $15 million in FY1999 for tobacco price support operations. This cost covers primarily salaries for a few headquarters personnel and substantial 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. Countering this contention, program supporters point out that the deficit reduction assessment brings in about $32 million, about 2.0 times as much as the administrative costs. Program supporters have, in the past, introduced legislation to earmark sufficient deficit reduction assessment monies for administrative costs, but thus far the proposal has not been enacted.

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 is 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 $38 million in FY1998, and are budgeted at $39 million for FY1999.

During congressional consideration of the FY1998 agriculture appropriations bills (H.R. 2160, S. 1033), an attempt was made to incorporate language in the proposed law to prohibit federal funds from being used for crop insurance related to tobacco production and marketing. Proponents of the amendment stressed the unhealthful nature of tobacco and the need to eliminate federal activities that assist in its production. Opponents pointed to the remote link between programs that assist farmers and consumers' choice to smoke, and the need for tobacco farmers to receive assistance in sound management related to natural risks (as typically offered for other crops). Contentious floor debates ended with the defeat of the amendment in the Senate on July 23 and in the House on July 24, 1997.

Tobacco Inspection and Grading

The USDA's Agricultural Marketing Service (AMS) carries out inspection and grading services at tobacco auction markets. 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 83 cents per 100 pounds). In FY1999, the tobacco inspection and grading fees are budgeted to bring in $17.4 million, which is 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 FY1999 is budgeted at $994,000. 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 Service (CSRS).[1] Annual research spending by the USDA averaged about $6.6 million until it was terminated under the FY1995 agricultural appropriations law and subsequent laws. University scientists, using about $1.7 million in USDA funds, continue to do basic plant research utilizing the tobacco plant as a model, but it is used only as an instrument for broader plant research and is not considered relevant to the tobacco industry.

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

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[1]In 1994 USDA reorganization, CSRS and ARS were combined, along with the Extension Service, into the Cooperative State Research, Education & Extension Service (CSREES).

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 federal and state extension staff, given their close proximity to researchers, continuously train the county agents and design and prepare materials for use by the county agents. In FY1999, the Cooperative State Research, Education, and Extension Service (CSREES) is budgeted to use $646 thousand on tobacco-related extension activities.

On June 12, 1996, a House floor vote was taken on the FY1997 agriculture appropriations bill (H.R. 3603, P.L. 104-180), to prohibit federal funds from being used for extension activities (and crop insurance) related to tobacco. The amendment was defeated by two votes. There was no such vote in the FY1998 agriculture appropriations bill.

Economic Analysis

The Economic Research Service (ERS) is responsible for economic analysis and forecasting 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 FY1999 is budgeted at $98,000.

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 is budgeted to be $142,000 in FY1999.

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 $249,000 in FY1999.

Table 1. USDA Tobacco-Related Net Budgetary Expenditures, Estimated FY1998 & Budgeted FY1999

USDA Agency ▸ Activity or program	FY1998 Estimate $000	FY1999 Budget $000
Commodity Credit Corp/Farm Service Agency		
▸ Administrative expenses of price support—salaries and office expenses of USDA tobacco program administrators.	16,206	15,407
▸ Deficit reduction assessment—assessment on all tobacco marketings for purposes of federal deficit reduction.	(30,455)	(30,747)
▸ Tobacco price support loan operations—price support program loan outlays less repayments.	316,758	(18,076)
Risk Management Agency		
▸ Crop insurance—tobacco crop loss indemnity payments and administrative expenses, less grower premiums.	38,271	38,995
Agricultural Marketing Service		
▸ Inspection & grading—inspection and grading for quality characteristics and pesticide residues provided on a fee-for-service basis.	0	0
▸ Market news reporting—collection and dissemination of auction market prices and sales volume data.	965	994
Cooperative State Research, Education, and Extension Service		
▸ Extension activities—extension education and technical assistance.	680	646
Economic Research Service		
▸ Economic analysis and projections—supply, demand, & trade analysis, and projections related to tobacco	98	98
Foreign Agricultural Service		
▸ World market analysis—collection and analysis of foreign country economic data on tobacco production and trade	138	142
National Agricultural Statistics Service		
▸ Agricultural statistics collection—data collection on U.S. tobacco acreage, crop condition, yield, and production.	248	249
Total USDA net expenditures for tobacco-related activities	342,909	7,708

Source: Data are from the USDA's Office of Budget and Program Analysis, Program-By-Program Summary, Estimated Costs Related to Tobacco Activities, February 26, 1998; and the Commodity Credit Corporation, Commodity Estimates Book, FY 1999 Mid-Session Review, May 20, 1998.

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