Order Code RS20802
Updated June 10, 2004

CRS Report for Congress

Received through the CRS Web

Tobacco Farmer Assistance

Jasper Womach
Agriculture Policy Specialist
Resources, Science, and Industry Division

Summary

Efforts to reduce tobacco consumption in the United States, stimulated by the 1998 Master Settlement Agreement, have 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 is the federal price support program, which limits supply and raises the price of U.S. tobacco above competitive market levels. Consequently, foreign-grown tobacco is displacing U.S. tobacco in both domestic and world markets. Because of the drop in demand, farmers have asked for and received compensation and assistance from cigarette manufacturers and the federal government. Manufacturers pledged $5.15 billion in payments to farmers to be distributed over 12 years. Also, Congress has approved $328 million in tobacco loss payments to farmers for FY2000, $340 million for FY2001, another $129 million for FY2001, and $53 million for FY2003. In addition, losses on 1999-crop price support loan stocks, amounting to $625 million, were shifted to taxpayers.

This report will be updated as legislative events warrant.

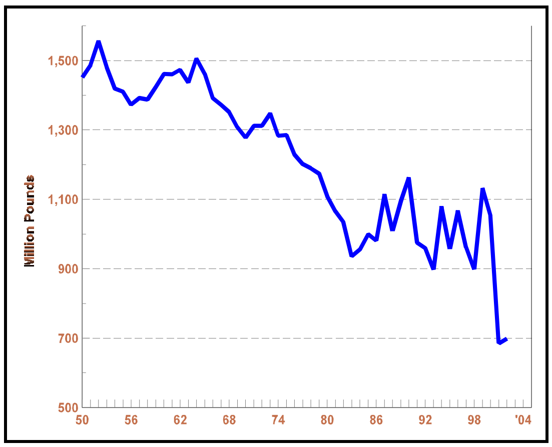
The tobacco price guarantee provided by the federal support program is supposed to support and stabilize the income of growers. However, farmers have seen an especially sharp drop in sales volume the last two years. In response, they have cut back production 51% since 1997. Like other farmers suffering economic hardship, tobacco growers have asked for and received assistance.

U.S. Tobacco Production and Markets

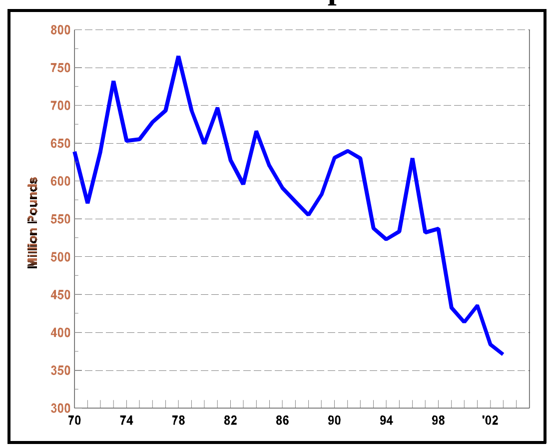
Based on the 2002 Census of Agriculture, about 57,000 farms in the United States produce tobacco. They primarily are located in Kentucky, North Carolina, and neighboring states. According to U.S. Department of Agriculture (USDA) data, crop year 2003 production was about 831.2 million pounds from 416,210 acres (4.6 acres per farm), for a yield of 1,997 pounds per acre. The average price is estimated at about $1.967 per pound, for a total crop value of about $1.635 billion.[1]

The utilization of U.S. tobacco leaf by domestic cigarette manufacturers and export sales 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

U.S. Leaf Domestic Use



U.S. Leaf Exports



federal price support program. Other countries have increased tobacco production and are selling to traditional U.S. markets, including to U.S. manufacturers. U.S.-manufactured cigarettes contain a growing proportion (about 55%) of cheaper imported tobacco. Additionally, U.S. leaf exports have shown a declining trend for at least the past 20 years (down to about 7.7% of world exports). The disadvantage of U.S. tobacco is illustrated by its average price during 2003 of $3.49 per pound (declared weight) leaving U.S. ports compared to $1.19 for foreign tobacco entering those same ports.[2] The higher quality of U.S. tobacco helps offset some of its price disadvantage, but not enough to prevent the loss of market share.

Adding to the difficulties of tobacco farmers is 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

Since the 1930s, tobacco farmers have benefitted from a federal price support and stabilization program (see *Tobacco Price Support: An Overview of the Program*, CRS Report 95-129). Federal law specifies a guaranteed minimum price for leaf tobacco. The price guarantee is achieved by controlling supply. Each tobacco farm is assigned a marketing quota that balances national production with domestic and export demand.

---

[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.

Any tobacco that does not bring at least the guaranteed price is purchased by a "price stabilization cooperative" with money borrowed from the USDA's Commodity Credit Corporation (CCC).[3] The 2004 crop year support price for flue-cured tobacco is $1.690 per pound, and for burley it is $1.873.

By law, the tobacco loan operations of the CCC are to function at no net cost to taxpayers. Price stabilization cooperatives that borrow money from CCC earn revenue from the sale of tobacco acquired from farmers and this money is used to make repayments with interest. If the revenue from tobacco sales is insufficient to cover the obligations to CCC, funds are withdrawn from a no-net-cost assessment pool. This pool of money is generated from an assessment on every pound of leaf tobacco marketed. The assessment on 2004-crop flue-cured is 10¢ per pound, and on burley it is 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 means tobacco marketing quotas have been larger in subsequent years than they would have been 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 parallels 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 has lived up to its mandate of no net cost to taxpayers, Congress has 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 have declined as domestic and export demand has dropped. In 1999 and 2000, the quota reductions were especially large and Congress

---

[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.

approved additional federal assistance. The quota loss assistance amounted to about $1 for each pound of quota loss. The FY2000 appropriation for USDA (P.L. 106-78, Section 803(c)) provided $328 million to be distributed to tobacco farmers as "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 directed 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 are 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**

Manufacturer Compensation for Farmers

The 1998 Master Settlement Agreement between cigarette manufacturers and states' attorneys general obligates the manufactures to pay states $246 billion over 25 years. In addition, the Agreement restricts marketing activities and funds anti-tobacco advertising. An explicit goal is to reduce cigarette consumption. However, any reduction in cigarette consumption indirectly decreases 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. In addition and of their own accord, 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 are responsible for designing the allocation among tobacco farm operators and absentee quota owners.

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	38.0%	$1,954,425	$144,210	$106,260	$151,800	$189,750	$111,953
KY	29.7%	$1,527,490	$112,708	$83,048	$118,640	$148,300	$87,497
TN	7.6%	$389,855	$28,766	$21,196	$30,280	$37,850	$22,332
SC	6.9%	$357,410	$26,372	$19,432	$27,760	$34,700	$20,473
VA	6.6%	$338,870	$25,004	$18,424	$26,320	$32,900	$19,411
GA	5.9%	$301,275	$22,230	$16,380	$23,400	$29,250	$17,258
OH	1.4%	$70,040	$5,168	$3,808	$5,440	$6,800	$4,012
IN	1.2%	$59,740	$4,408	$3,248	$4,640	$5,800	$3,422
FL	1.1%	$58,195	$4,294	$3,164	$4,520	$5,650	$3,334
MD	0.6%	$31,930	$2,356	$1,736	$2,480	$3,100	$1,829
PA	0.4%	$22,145	$1,634	$1,204	$1,720	$2,150	$1,269
MO	0.4%	$21,630	$1,596	$1,176	$1,680	$2,100	$1,239
WV	0.3%	$14,420	$1,064	$784	$1,120	$1,400	$826
AL	0.1%	$2,575	$190	$140	$200	$250	$148
Total	**100.0%**	**$5,150,000**	**$380,000**	**$280,000**	**$400,000**	**$500,000**	**$295,000**

Policy Issues

When Congress attempts to address the economic problems of tobacco farmers, it is faced with complexities compounded by apparent 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 examines the issues in detail and surveys policy options.

It is the policy of the federal government to discourage consumption of cigarettes (especially by young people) on the grounds that they are addictive and harmful to human health. To the extent Americans reduce their consumption of tobacco products, tobacco farmers are faced with a shrinking market. So, federal public health policy works to the disadvantage of tobacco farmers.

Second, it has been federal policy for more than 60 years to balance U.S. tobacco production with demand, but at a price that is 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 has caused it to be displaced by less expensive foreign-grown supplies in both this country and worldwide.

As the demand for high-priced U.S. tobacco has declined, marketing quotas and farm tobacco revenues correspondingly have declined. Economic theory suggests that the support price be reduced enough that U.S. tobacco would be competitive in global markets. This option runs into two sources of opposition. Health advocates are one possible source of opposition and tobacco quota owners are the other source. Health advocates are not in favor of lower leaf prices, which ultimately would translate into lower costs for cigarette manufacturers.

Generally, quota owners oppose lower prices because the benefits of high-priced tobacco have been capitalized into quota values, and these values would be eroded. The estimated 260,000 absentee quota owners who earn rent on their quota rights are among the strongest advocates for maintaining high quota values. There are fewer than 90,000 farmers growing tobacco and they themselves own quotas. For these farmers, quotas are an asset that they do not want to lose. However, a significant number of the farmers rent a large proportion of their annual marketing quota in order to make their operations economically viable. These commercial farmer operators may favor changes that reduce quota values if the changes would make U.S. tobacco globally competitive.

Historically, according to University of Kentucky researchers,[5] the average rental rate for burley quota has been about 40¢ per pound. However, rent in crop year 2001 was inflated to about 62¢ but has since declined to about 50¢. The higher rent was attributed to federal quota loss payments and the Phase II settlement payments. Rather than making U.S. tobacco more competitive in the marketplace, the recent federal and manufacturer assistance has increased the cost of production for farmers because it has been capitalized into higher quota rents.

Some policy makers have suggested that quota be eliminated and owners be compensated for lost value through a quota buyout program. Elimination of marketing quotas, combined with a reduction or elimination of price support could be expected to result in increased tobacco production and sales. An unanswered question is how to pay for a quota buyout. A suggestion is through increased taxes on cigarettes or an assessment on manufacturers. While these options may avoid the political difficulties of using general taxpayer funds, they could adversely impact cigarette smokers and further erode the domestic demand for tobacco. The State of Maryland has implemented a tobacco farmer buyout program paying $1 per pound each year for 10 years using State funds from the Master Settlement Agreement.

Tobacco manufacturers would be the direct beneficiaries of any policy change reducing the price of leaf tobacco. Some manufacturers are interested in financing a quota buyout program that is accompanied by reduced leaf prices. However, the buyout proposal is complicated by its political marriage to proposed legal authority for the Food and Drug Administration (FDA) to regulate cigarettes. Anti-smoking and public health advocates are keenly interested in new FDA authority, and a consensus appears to have been reached is contained in the identical bills S. 2461, DeWine-Kennedy, and H.R. 4433, Davis-Waxman. Congress has been refining various quota buyout options, and several bills are summarized in CRS Report RL31790, *Tobacco Quota Buyout Proposals in the 108th Congress*.

---

[5] Will Snell, What Is the Value of Burley Tobacco Quota?, March 2002.