



AgEcon SEARCH
RESEARCH IN AGRICULTURAL & APPLIED ECONOMICS

The World's Largest Open Access Agricultural & Applied Economics Digital Library

This document is discoverable and free to researchers across the globe due to the work of AgEcon Search.

Help ensure our sustainability.

Give to AgEcon Search

AgEcon Search
<http://ageconsearch.umn.edu>
aesearch@umn.edu

*Papers downloaded from **AgEcon Search** may be used for non-commercial purposes and personal study only. No other use, including posting to another Internet site, is permitted without permission from the copyright owner (not AgEcon Search), or as allowed under the provisions of Fair Use, U.S. Copyright Act, Title 17 U.S.C.*

TOBACCO PROGRAMS AFFECTING TOBACCO GROWERS

D. H. Carley

Tobacco has been a farm policy issue since Colonial times. Government policies and programs related to tobacco have become progressively more controversial, especially with the health issue concerns since the 1960's. Significant changes in the Federal government program have been made as a result of the expressed intent of Congress in the 1981 Agriculture and Food Act that the tobacco program be operated with a no net cost to tax payers, other than administrative expenses. In keeping with the intent, a no net cost tobacco program was signed into law in July 1982.

The current program is expected to reduce government costs by passing such costs as grading and inspection on to growers. Under the new law producers must contribute to funds or accounts to assure that price support loans are fully repaid. The Secretary of Agriculture is given discretion in setting price support levels. Another change, affecting the demand side of the market, is the increase in the federal excise tax from 8 cents to 16 cents per pack in 1983.

Tobacco is a highly regulated commodity from the farm to the consumer. Currently production is limited by poundage quotas with government price supports for burley and flue-cured tobacco and acreage allotments for some of the less important types. Tobacco growers must certify that they do not use prohibited insecticides. Flue-cured growers must designate the warehouse in which they intend to sell their tobacco. Warehouse firms are regulated with regard to the sales schedules, charges for services rendered, procedures for opening and closing, and proper accounting and licensing.

All tobacco leaf received by manufacturers and/or exporters must be accounted for so that the several taxes may be collected. Regulations with regard to health aspects related to smoking have been implemented including bans on cigarette advertising on radio and television, and restrictions on smoking in public places.

Tobacco is an important source of income in the major states in which it is produced. About 92 percent of all tobacco is produced in North Carolina, Kentucky, South Carolina, Virginia, Tennessee, and Georgia — accounting for about 20 percent of total cash receipts from agriculture in those states. Georgia ranks sixth among states with tobacco accounting for about 7 percent of cash receipts from agriculture. Gross income per acre of tobacco in 1981 ranged from an average of \$3,547 in North Carolina to \$3,913 in Kentucky. In Georgia tobacco averaged \$3,640 per acre. Even though total acreage has decreased in Georgia, yields have increased so that total production has remained fairly stable at about 120 million pounds. Increasing prices have contributed to increasing gross receipts.

The cost of the price support loan and program and other expenditures has been decreasing. Net USDA costs were \$70.3 million in the year ending September 30, 1977. In 1980 and 1981 the net costs were about \$32 million. About one-half of the costs were for administration of the program. In contrast revenue to the Federal Government through taxes on tobacco products was \$2.5 billion in 1979-80 and 1980-81. State and local governments received more than \$3.7 billion in tobacco tax revenues. Doubling of the federal cigarette tax in 1983 will bring in additional revenue exceeding \$2 billion. Tobacco policy is important in those states and to those farmers who own quotas as well as those who grow tobacco. This paper examines the effects of some of these policies on the industry with emphasis on current issues and future direction.

RESULTS OF PAST AND CURRENT PRICE SUPPORT AND PRODUCTION ADJUSTMENT PROGRAMS

Tobacco producers have been susceptible to cycles of overproduction regularly following years of favorable prices necessitating government programs designed to stabilize production. Since the Agricultural Adjustment Act of 1938, tobacco production has been controlled either by acreage allotments and/or marketing allotments better known as poundage quotas. With an acreage allotment each grower is allowed to sell tobacco only from allotted acres in any year under rules of the tobacco program. A poundage quota is similar in that the grower may sell only that volume of tobacco that was allocated in that given year. Allotments and quotas are based on history of production on a given farm and change with the provisions of the tobacco program.

Despite acreage controls for burley and flue-cured tobacco, production increased at a rate substantially above domestic use and exports. Guaranteed minimum prices induced growers to use production practices that maximized yields even though the quality of tobacco was sometimes diminished. Production exceeded domestic and export disappearance resulting in an accumulation of surplus tobacco under the loan program.

In the 1960s, growers approved an acreage-poundage program for flue-cured tobacco and a poundage program for burley. These programs provide that each farm having a tobacco quota may market that specified quantity of tobacco expressed in pounds of quota. Production in excess of 110 percent of the quota cannot be sold, but if sales are less than 100 percent of quota the deficit marketings are added to the farmers quota the following year.

Growers of flue-cured tobacco may exceed their acreage allotments but not their quota if they agree to leave the bottom four leaves in the field. These are the lowest quality leaves and can be pulled and dropped in the field.

Prior to the poundage quota program for flue-cured tobacco, marketings were averaging 7% above disappearance. After adoption of the program in 1965, marketings decreased to 92 percent of disappearance. In the 1970s, there was a fairly good flue-cured tobacco supply-demand balance (Table 1). Marketings and disappearance of burley were also fairly well balanced with some actual increases compared to flue-cured.

Price support levels are determined by a formula that maintains a specified relationship between tobacco prices and prices of goods and services purchased by farmers in 1959. The goal of this pricing method is to provide a basis for the prices received for tobacco to change in relationship to the prices paid for goods purchased and thus maintain an equivalent purchasing power to the base period. The average of the parity index for the three calendar years immediately preceding the crop year is divided by the 1959 parity index to obtain the price adjustment factor. Thus, the support price changes in line with changes in the prices of goods and services purchased by farmers.

Basically, tobacco programs are designed to take advantage of the inelastic demand of a habit forming commodity. Supplies are restricted in order to raise prices above the level that would exist in an open market. National marketing quotas limit sales to a level projected to meet domestic and export needs (including reasonable carryover stocks) at prices at or above the support level. Prices received for tobacco in the 1970s averaged above the support price. The difference is a reflection of the quality of tobacco as well as a balance between supply and demand.

The national quota is assigned to individual farms according to production history. With a decreasing trend in flue-cured quotas, the quota per farm decreases. From 1974 to 1982 the average quota per allotment decreased from 6,514 to 4,065 pounds.

A feature of the tobacco program is the provision for lease and transfer of allotted quotas. Each farm has a quota assigned to it according to its history of tobacco production. There are in excess of 25,000 allotted quotas in Georgia. Through 1982 quotas remained with the designated farm but could be leased and transferred from one farm to another within a county. Allotments and quotas could not be sold separate from the farmland. This provision allows growers to obtain additional quotas from those who do not wish to grow tobacco. Thus, more acreage can be assembled under one management with gains in production efficiency.

In 1969, 49 percent of the Georgia allotments were transferred representing 35 percent of the acreage and 31 percent of the effective quota. In 1981, 80 percent of the allotments were leased out representing 65 percent of the quota. The poundage leased in per farm in 1969 averaged 6,300 pounds but by 1981 3,598 farms leased in an average of 21,180 pounds of quota in Georgia. The quota of those farms leasing out averaged 3,710 pounds.

Lease and transfer provisions have created an active rental market for tobacco quota. The "economic rent" per pound of quota is the gross return

minus production cost. In the short run, rental rates may be the difference between variable costs and returns. In the long run rental rates need to reflect total costs. The simple average of rental rates in 1966-68 was about 18 cents per pound of quota but ranged up to 40 cents. In 1975-76 the average rent had increased to a range of 20 to 28 cents per pound averaging about 25 cents. By 1979, rents averaged about 40 cents per pound but decreased to about 35 cents in 1980 and to 30 cents in 1981. However, in most years there was a range of 15 to 50 cents per pound. Rental rates vary by geographic area, yield levels, size of quotas, and efficiency of grower operation.

Cost of production data compiled by USDA for the 1970s and early 1980s indicate that the average rental rate was in line with the difference between the average price received and the average cost of production. The production costs not including land and quota averaged about 65 cents per pound in 1975-76. Prices received ranged from \$1.00 to \$1.10 per pound. Rent averaged 25 cents per pound. By 1979, costs increased to about 80 cents, the price averaged \$1.41 and the rent averaged about 40 cents. Costs increased to about 95 cents in 1980 and 1981, but prices did not respond by the same amount with rent decreasing to a 30-35 cent range.

Mechanization of tobacco harvesting and curing, increasing costs of production, a decreasing demand for tobacco, and the tobacco program have led to structural changes in flue-cured tobacco farms. A Georgia study found that of 69 growers in 1967 only 23 were still growing tobacco in 1979. Growers that discontinued production generally had small allotments, harvested by hand and used conventional curing barns requiring tying tobacco on sticks to hang in the barns. Remaining growers increased the size of their operations by renting in allotment, cured tobacco in barns in which tobacco was packed in bulk racks and more than one half used self-propelled mechanical harvesters. The other growers used semi-mechanical harvesting aids.

DEMAND FOR TOBACCO

National marketing quotas are based on projected domestic use and exports including reasonable carry over stocks. Therefore, the demand for tobacco products is the critical factor affecting tobacco quota available to growers. The domestic use of flue-cured and burley tobacco is primarily for cigarettes. Utilization in cigarettes decreased from a 600 million pound level of flue-cured in the early 1970s to 500 million pounds or less in 1982 (Table 2). Use in other products decreased 20 million pounds. In addition, the export market has varied from 509 to 599 million pounds in the 1970s and early 1980s. While exports are about 100 million pounds above the 1960s, domestic use is down almost 200 million pounds. Domestic use of burley has remained relatively steady but exports have increased.

Per capita cigarette consumption decreased from a high of 4,300 cigarettes in the mid 1960s to an estimated 3,778 in 1982. Moreover, tobacco leaf per 1,000 cigarettes trended steadily downward with flue-cured leaf decreasing 30 percent and burley decreasing 17 percent in the 1970s (Table 3). Increased use of imported tobacco, up 70 percent in the 70s, the shift to filter cigarettes, increased use of

sheet tobacco, and reduction in cigarette circumference have contributed to the decrease in leaf use per 1,000 cigarettes. Aggregate domestic cigarette consumption has increased slowly due to population increases but the use of U.S. grown leaf is stable or decreasing.

The Surgeon General's Reports indict smoking as a major health problem. Bans on radio and TV advertising and limitations on smoking in public places, have reduced smoking. Other countries have also initiated efforts to reduce smoking. Thus, there is a continuing conflict in policy in regulating tobacco production while at the same time discouraging tobacco use because of its potential health problem.

FUTURE PROSPECTS FOR TOBACCO PROGRAMS

Each year anti-smoking bills are introduced in Congress attempting to abolish the tobacco program, including one in 1982. The 1981 Agricultural Act emphasized market orientation and reduced federal expenditures for all farm programs. The tobacco program was attacked from the perspectives of unwise government expenditure and the health issue. Congress passed a "No Net Cost Tobacco Program Act" in 1982 (H.R. 6590). The basic provisions were:

- 1) To be eligible for price supports beginning with the 1982 crop, tobacco producers contribute to a no net cost tobacco fund. In 1983, quota owners who lease out quota must also pay such a fee on the quantity of tobacco crop represented by such lease. The amount of the fee will be established each year.

- 2) The Secretary of Agriculture was authorized to hold price supports as low as 65% of the amount of increase determined under the regular formula. Thus, support rates will not necessarily increase in proportion to the increase in farm costs as measured by the Parity Index.

- 3) The Secretary was provided the authority to reduce support rates for tobacco grades in excess supply but the weighted average support for all grades must be at least 65% of the increase specified by law.

- 4) For the first time owners of flue-cured allotments and quotas may sell these rights separately from the farms (land) to which the allotments are attached. They must be sold in the same county and must be sold to active growers. A grower can have not more than 50 percent of eligible cropland planted to tobacco.

- 5) Corporations, utilities, educational and religious institutions owning tobacco allotments but not significantly involved in farming are required to sell their allotments. The allotments must be sold to active producers or people who plan to become active producers within the same counties.

Sellers of flue-cured tobacco were required to pay for the tobacco inspection and certification (grading) at a rate of \$0.0055 per pound. Thus, the grower assessment along with the inspection fee are expected to result in a tobacco program that can be operated with no net cost to taxpayers.

The future of tobacco production depends on trends in domestic use and the export market. Neither appears to be growth oriented. However, the new program which allows price support rates to be increased at less than the inflation rate will result in a lower real price for tobacco. This could result in increased exports or at least a reduction in the loss of the U.S. share of world markets, a reduction in

imports, and an increase in domestic demand. Thus, the national marketing quota may stabilize or possibly increase, but increased taxation of tobacco products may offset lower real tobacco prices.

Should the cost of production increase at a faster rate than the support price, the residual for quota rent will decrease. Negotiable tobacco quotas within counties will allow growers to accumulate tobacco acreage under one management. Quotas can be sold separately from the sale of land. Many owners of quotas not growing tobacco may opt to sell the quotas instead of renting them out. Quota values will vary. Factors determining quota values include 1) future support prices, 2) the size of future quotas as each farm quota is a pro rata share of the national marketing quota, 3) competition for quota by current and new growers, 4) future assessments for the no-cost fund, 5) interest rate for borrowed funds, 6) inflation rates and 7) uncertainty of future legislation changes in the tobacco program.

The no net cost program means that tobacco growers will assume the costs associated with the program. This should negate the conflict within the government with respect to regulating the production of tobacco and at the same time protecting the health and safety of its citizens. The costs of the tobacco price support program will be paid by the growers. If the supply does not clear the market at slightly above the support rate, then producers will be assessed at a higher rate to cover the costs of the program.

CONCLUSIONS

The tobacco program with its restrictions on production through individual farm quotas has maintained a reasonable supply-demand balance. Restricting the right to grow tobacco while maintaining market prices above production costs has created an active rental market for tobacco quotas. Support prices tied to the Parity Index assured price increases in line with production costs. The health issue has reduced smoking, thus the decreased demand for tobacco is reflected in reductions in production quotas.

The emphasis on the health issue and reduced government expenditures forged substantial changes in the tobacco program in 1982. Growers will finance tobacco stabilization programs through an assessment with price support levels increasing at a rate below the rate of increase in costs. Moreover, allotments may change ownership within the same county without a change in land ownership. Thus, tobacco growers should be in a position to maintain a price support program. Future prospects for tobacco depend on the health issue in the United States and world wide. Restraint of price increases may result in some increase in use, both domestically and in world markets. However, stagnation or at best slow growth is the most likely future scenario for the tobacco industry.

D. H. Carley is Professor, Dept. of Agricultural Economics, Georgia Experiment Station, University of Georgia College of Agriculture.

References

97th Congress, 2nd Session. 1982. No Net Cost Tobacco Program Act of 1982. H. R. 6590, The Senate of the United States.

Pugh, Charles R. 1982. The Outlook for Tobacco Under a No Net Cost Program. Presented at the Outlook Conference, N. C. State Univ.

U.S. Dept. Agri. 1982. Annual Report on Tobacco Statistics, Agri. Mkt. Serv. St. Bul. 685.

U.S. Dept. Agri. 1981 and 1982. Tobacco Outlook and Situation, Econ. Res. Serv., selected issues.

Table 1. Marketings, supply and disappearance of flue-cured and burley tobacco, U.S., selected 3-yr. periods.

Marketing year	Flue-cured		
	Marketings	Total supply ^b	Disapp.
Average	- - - - - mil lbs - - - - -		
1970-72	1,092	3,012	1,167
1973-75	1,273	2,942	1,232
1976-78	1,215	3,224	1,159
1979-81	1,059	3,076	1,044
1982 ^a	1,003	3,148	-
Marketing year	Burley		
	Marketings	Total supply ^b	Disapp.
Average	- - - - - mil lbs - - - - -		
1970-72	541	1,853	579
1973-75	570	1,701	603
1976-78	631	1,830	617
1979-81	576	1,656	613
1982 ^a	779	1,885	-

a Estimated.

b Includes more than one years' marketings.

Table 2. Disappearance by use of flue-cured and burley tobacco, U.S., selected 3-yr. periods.

Marketing year	Flue-cured		
	Domestic Use Cigarettes	Total	Exports
Average	- - - - - mil lbs - - - - -		
1970-72	579	656	511
1973-75	634	676	556
1976-78	581	608	551
1979-81	520	527	517
Marketing year	Burley		
	Domestic Use Cigarettes	Total	Exports
Average	- - - - - mil lbs - - - - -		
1970-72	467	518	61
1973-75	467	521	82
1976-78	454	499	118
1979-81	445	484	129

Table 3. Cigarette output and leaf used, U.S., selected 3-yr. periods.

U.S., selected 3-yr. periods:				
Year	Cigarette output			U.S. consumption
	- - - - - billions			- - - - -
1970-72	586			562
1973-75	643			599
1976-78	685			616
1979-81	718			631
Year	Quantity per 1000 cigarettes ^a			
	Flue-cured	Burley	Imported	Total
	- - - - - lbs - - - - -			
1970-72	.930	.680	.296	1.944
1973-75	.878	.658	.331	1.895
1976-78	.781	.601	.371	1.781
1979-81	.660	.564	.504	1.759

a Unstemmed processing weight