

---

# Tobacco Production in Tennessee: An Economic Perspective

---

**Kelly Tiller**

Agricultural Policy Analysis  
Department of Agricultural Economics  
The University of Tennessee

---

## Tobacco Income in Tennessee

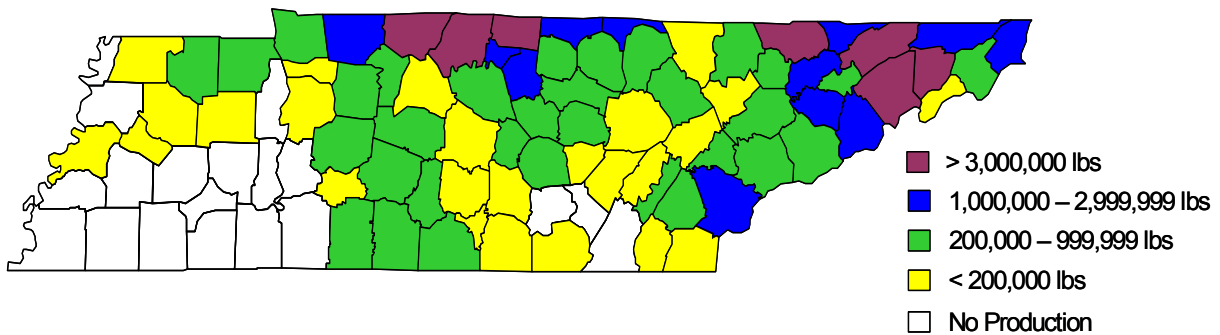
---

Tobacco has played an important role in Tennessee agriculture for many generations. Tobacco has been a primary factor in sustaining a large number of small family farms, especially in East Tennessee. Tobacco income has played an important role in allowing many rural economies to thrive and grow in areas of the state where few economic alternatives are available. The tobacco production industry has witnessed a number of dramatic changes and challenges over the last few years and these changes will affect the future of the Tennessee tobacco economy. Despite recent and anticipated future changes and uncertainties, tobacco production is expected to remain an important part of the state's agricultural economy.

Three types of tobacco are grown in Tennessee: burley, dark-fired, and dark air-cured. The dominant type is burley tobacco (type 31), which is a light air-cured tobacco and a primary component of the American-blend cigarette (along with flue-cured tobacco and oriental tobacco). Historically, about 85 percent of all tobacco grown in Tennessee has been burley tobacco. Dark tobaccos (dark-fired tobacco, types 22 and 23, and dark air-cured tobacco, type 35) are primarily used for chewing tobaccos and snuff. About 14 percent of the state's tobacco production is dark-fired and one percent is dark air-cured.

Tobacco production is generally regionalized in Tennessee. A map of burley tobacco

**Figure 2.1. Burley Tobacco Production in Tennessee by County, 2000.**



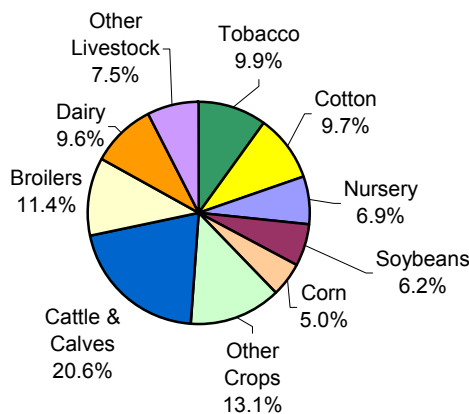
Source: Tennessee Agricultural Statistics Service.

production by county in Tennessee is presented in figure 2.1. Burley production is concentrated primarily in Northeastern and Northcentral Tennessee, where tobacco is grown on at least half of all farms in ten counties. Many of the counties most economically dependent on tobacco income also have the fewest economic alternatives, with high unemployment and low per capita incomes. Since cross-county lease and transfer of tobacco quotas has been permitted in Tennessee (approved in 1991), tobacco production in the state has gradually moved westward. In 1980, 57 percent of all burley in the state was produced east of the Cumberland Plateau (in the 25 counties comprising the eastern-most Agricultural Statistics District (ASD) in Tennessee). In 2000, only 48 percent of the state's burley crop was produced in the eastern ASD. Burley production in the two most western ASDs has increased from 7 percent in 1980 to 13 percent in 2000.

Tobacco remains a vital source of income in Tennessee, contributing nearly one out of every ten dollars in agricultural receipts in 2000 and leading all crops in cash receipts from farm marketings (figure 2.2.). Cash receipts from agricultural marketings in

2000 totaled \$2.02 billion, up just 3% from receipts in 1999 totaling \$1.96 billion. Livestock and crop receipts were nearly equal with crops contributing \$1.03 billion (51%) and livestock contributing \$990 million (49%). Cattle and calves led livestock receipts contributing over \$416 million, or more than one in ever five dollars of all agricultural receipts. Broilers contributed \$230 million, followed by dairy products, contributing \$193 million. Receipts from hogs were up more than 50% in 2000 to \$61 million, but still more than 40% below their 1996 level. Although still the leading crop in 2000, tobacco receipts were down 8% compared to 1999 to just under \$200 million, their lowest level in more than a decade. Receipts from cotton were just behind tobacco receipts at \$196 million. For the second year in a row, nursery crops were the third leading cash crop generating over \$140 million, followed by soybeans (\$126 million) and corn (\$102 million). Floriculture crops were up nearly 15% in 2000 and if combined with nursery crops, would account for the largest share of crop cash receipts in Tennessee. Tobacco, soybeans, and cotton have been the top three crops in cash receipts over the last decade.

**Figure 2.2. Tennessee Agricultural Cash Receipts from Farm Marketings, 2000.**



Source: Tennessee Agricultural Statistics Service.

---

## Trends in Tobacco Production

---

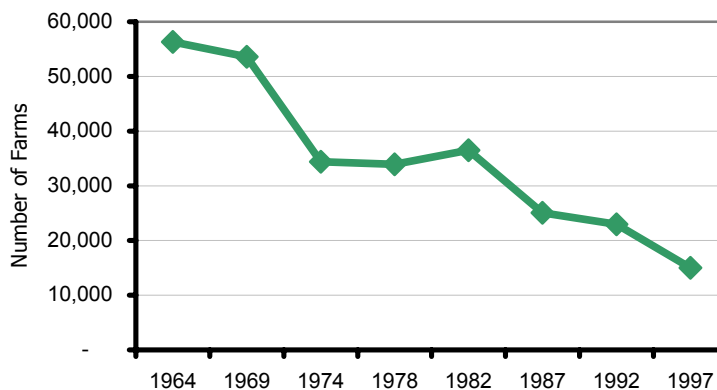
Tennessee is ranked third in the nation in pounds of tobacco produced and second in the nation in the number of tobacco farms behind Kentucky. The number of tobacco farms in the state is presented in figure 2.3. According to the U.S. Census of Agriculture, the number of tobacco farms in the state has been steadily declining for decades. The Census defines a farm as a tobacco farm if at least half of the farm's income is derived from tobacco production. In 1992, there were nearly 23,000 tobacco farms in the state, compared to just under 15,000 in 1997. That represents a loss of more than one third of the state's tobacco farms over five years. While the next comparable farm numbers won't be available until after 2002, the pace of the decline is expected to further escalate. The expected trend is for further consolidation and exit.

Tobacco acreage in Tennessee has declined significantly since the late 1990s. Tobacco acreage in the state since 1990 is pre-

sented in figure 2.4. During the 1990s, tobacco acreage in Tennessee ranged from 52,000 to 72,000 acres, averaging 61,000 acres over the last decade. Acreage increased through 1999 when it reached 63,000 acres. Tobacco acreage has fallen from 63,000 acres in 1999 to 46,000 acres in 2000 (down 27%) and 41,000 acres in 2001. Since 1999, tobacco acreage in the state has been reduced by more than one third. More than three of every four tobacco acres in the state is burley. Since 1999, burley acreage has declined slightly more than dark tobacco acreage. Declining tobacco acreage has been a direct result of declining tobacco quotas under the federal tobacco price support and supply control program.

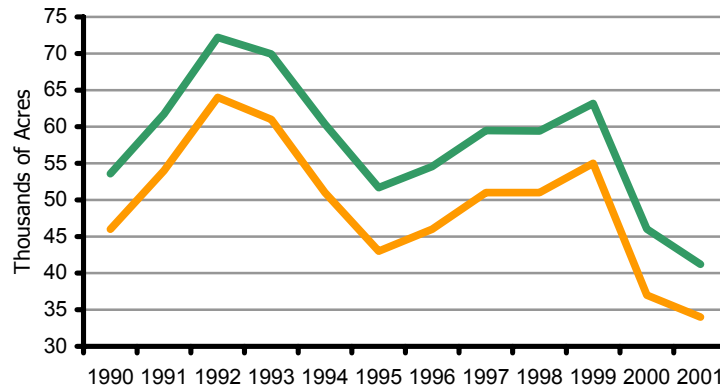
Tobacco production in Tennessee (and throughout the tobacco-growing Southeast) has declined significantly since 1999. The reduction in burley tobacco acreage and production in Tennessee has been a direct result of declining tobacco quotas. Since the 1930s,

**Figure 2.3. The Number of Tobacco Farms in Tennessee.**



Source: U.S. Census of Agriculture

**Figure 2.4. Tobacco Acreage in Tennessee.**



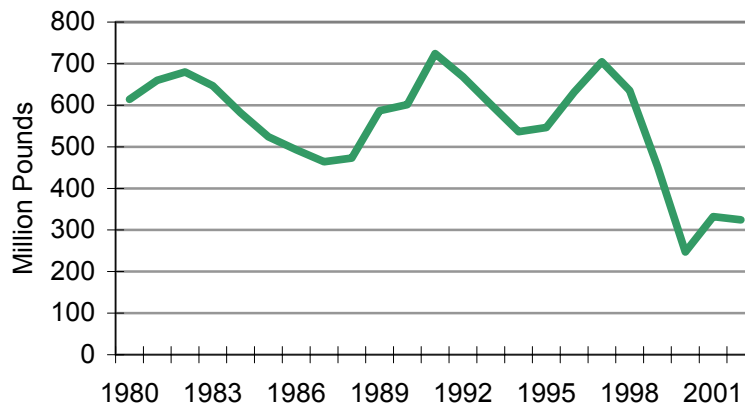
Source: Tennessee Agricultural Statistics Service.

tobacco production and marketing in the U.S. has been subject to a federal price support and supply control program. The amount of tobacco grown each year is determined by the tobacco marketing quota. The basic quota is calculated each year prior to the start of the production season by a predetermined formula which includes manufacturers' purchase intentions, adjustments for stock levels, and a three year export average. The basic quota is further adjusted by undermarketings or overmarketings from the previous marketing year to determine the effective

quota. The amount of tobacco a grower can market through the auction warehouse system or through private contracts is limited by the effective quota owned or leased by the grower, as quotas are a tradable asset. In Tennessee, tobacco quotas can be leased across county lines.

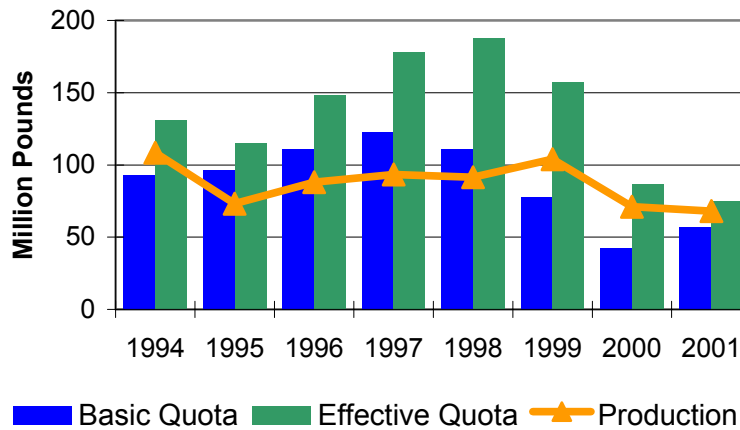
The federal tobacco program has been a major factor in sustaining a large number of small family farms in Tennessee. Burley tobacco basic quotas are presented in figure 2.5, with the 2002 basic quota estimated to

**Figure 2.5. Burley Tobacco Basic Quota.**



Source: USDA, Farm Services Agency.

**Figure 2.6. Tennessee Burley Tobacco Basic and Effective Quota and Production.**



Source: USDA, Farm Services Agency; Tennessee Agricultural Statistics Service.

be 324.2 million pounds. From 1980 to 1998, burley tobacco basic quota has averaged about 600 million pounds, ranging from 464 million pounds in 1987 to 705 pounds in 1997. Basic quota was cut by 9.8% in 1998 and 28.8% in 1999 followed by a dramatic 45.3% cut in 2000 to 247 million pounds. From 1999 to 2002 (as projected), basic quota has averaged 339 million pounds, which is 46% less than the average of the last two decades.

Figure 2.6. shows burley tobacco basic and effective quota in Tennessee since 1994, as well as burley production (2001 burley tobacco production is estimated). Tennessee has typically produced and marketed less tobacco than the amount allowed by the quota, leading to effective quotas that are significantly higher than basic quotas. Therefore, tobacco quotas have not historically limited total tobacco production in Tennessee. During the 1990s, tobacco production in Tennessee averaged 100.4 million pounds. Basic quota was cut 10 percent in 1998 and another 30 percent in 1999 and while the basic quota dipped below the historical production average in 1999 (down to 77.9 million pounds), effective quota remained sufficiently high so

that acreage and production were not significantly affected. In fact, harvested acreage in 1999 was the highest level since 1993 and, combined with average yields, production in 1999 was up 13.5 percent over 1998 and at its highest level since 1994. The 2000 basic burley tobacco quota was set at 42 million pounds, 45 percent below the 1999 basic quota. This level represents a decline of nearly two thirds since 1997. Effective quota in 2000 fell to 87 million pounds, indicating that the buffer protection of the gap between basic and effective quota was being eroded. In 2001, basic quotas recovered somewhat, to 56.9 million pounds (still 54% lower than the 1997 level). However, effective quota continued to decline to 74.8 million pounds.

Burley tobacco production for 2001 is forecast at 68 million pounds, which would be the smallest crop since 1989. The decline is due to a further reduction in burley tobacco acreage of more than 8% down to 34,000 acres. While tobacco basic quota in Tennessee increased by about one third in 2001, the effective quota further decreased by 14% to just under 75 million pounds, leading to further reductions in tobacco acreage. The effective quota in Tennessee in 2001 was 60%

---

lower than the 1998 level and nearly one third less than the five-year average production level. Tobacco quotas are projected to be very near the 2001 level in 2002. Beginning with the 2002 crop year, the amount of unutilized quota eligible to be carried forward will be limited to 10% of the basic quota. Thus, burley carryforward in 2002 is limited to 10% of basic quota in 2001, or 33.2 million pounds. In Tennessee, effective quota will likely decline somewhat and production will be further reduced.

In addition to their direct impact on tobacco production, declining tobacco quotas have contributed toward escalating quota lease prices in recent years. The steep increase in quota lease costs has made a significant difference in net income from tobacco in Tennessee, with higher lease costs directly reducing the net profit per pound of tobacco.

While exact quota rental rates for the state are not available, it has been estimated that average burley quota rental rates have moved from about \$0.08 to \$0.10/lb for most of the 1990s to about \$0.15/lb in 1999, \$0.35/lb in 2000, and \$0.45/lb in 2001. While these figures estimate the statewide average, the range of regional and individual rates varies widely. By comparison, average quota lease prices in Kentucky (where data are collected annually through a county-level survey of growers) have averaged around \$0.40/lb for most of the 1990s before increasing to \$0.60/lb in 2000 and \$0.63/lb in 2001. Burley quota lease rates have generally been considerably lower in Tennessee than in Kentucky due to cross-county lease and transfer in Tennessee and widespread sharecropping arrangements in Kentucky.

In addition to tighter quota markets, Phase II and TLAP payments that have been made to tobacco growers and quota owners in recent years have also contributed toward increasing quota lease costs. The separate National Tobacco Growers Trust (commonly called Phase II) that followed the tobacco Master Settlement Agreement expects to pay Tennessee growers and quota owners about \$390 million through 2010. Payments must be made directly to growers or quota owners of cigarette tobaccos (burley, but not dark tobaccos), allocated according to rules established in each state by a state certifying board.

In 1999, Tennessee's Phase II board allocated 90% of the payments to tobacco growers and 20% to quota owners, based on production and quota in the previous crop year. For 2001, the ratio was changed to 90%/10%, although the payment year was again rolled forward. Phase II payments in Tennessee totaled about \$29 million in 1999, \$17.5 million in 2000, and \$26 million in 2001. According to the payment schedule, payments are expected to increase to about \$38 million per year for the next 7 years before declining to \$22 million in 2009 and 2010. In addition to Phase II direct payments, growers and quota owners have also received payments over the last two years under the Tobacco Loss Assistance Program, or TLAP payments. In addition to Phase II payments, Tennessee received about \$32 million in TLAP payments in 1999 and about \$33 million in TLAP payments in 2000. Phase II and TLAP payments have significantly increased the "mailbox value" of tobacco over the last few years. They have also contributed toward higher quota lease prices as anticipated or expected direct payments for quota have been bid into the lease price.

---

## Looking Toward the Future

---

The U.S. tobacco industry continues to face unprecedented levels of uncertainty about the future of tobacco production. The issue of contracting is one source of uncertainty. Over the entire burley belt, about 63% of tobacco was contracted in 2001, compared to about 26% last year. Contracting was more prevalent in Tennessee, with about 80% of pounds contracted. In the flue-cured region, about 80% of the crop was under contract. Average burley contract prices have been about \$0.04/lb higher than auction market prices.

A number of questions about contracting remain unanswered, especially related to the evolution of contracts over time and the impact of contracting on the federal tobacco program. There are still a number of grower concerns about contracting prospects in the absence of a federal price support program. Uncertainty about the ability to fulfill export demands under a contract system also exists. A referendum is scheduled for Spring 2002 on the question of mandatory federal grading of all tobacco (contract and auction sales). Passage of the referendum requires a simple majority, unlike the program continuation referendum.

Another source of uncertainty for many tobacco growers and quota owners is a tobacco quota buyout. Talk of a quota buyout is not anything new, but over the last few years, discussion has heightened considerably. The most recent round of interest was sparked by the release of the President's Tobacco Commission report in May 2001, which recommended, among other things, a quota buyout. The Commission recom-

mended that quota owners be compensated \$8/lb for quota owned, to be paid out over five years. The grower of the quota would be compensated an additional \$4/lb of quota if they agree to exit tobacco production or \$2/lb if they elect to continue tobacco production under a new tobacco production permit system. The program was projected to cost about \$15 billion and the Commission recommended an increase in the federal cigarette excise tax of about \$0.17/pack to fund the program.

To date, there has not been any specific legislation introduced related to the President's Tobacco Commission report. While considerable support for some kind of a "buyout" exists, prospects are uncertain at best. A large number of questions remain to be addressed—not the least of which is a buyout funding source—and a successful buyout proposal will likely require considerable input from all stakeholder groups including tobacco growers, quota owners, tobacco companies, public health interests, farm organizations, and government entities. Before any buyout proposal can move forward, a number of questions would have to be addressed such as:

- Appropriate payment rate(s)
- Payment basis
- Payment period
- Tax treatment
- Program provisions (if any)
- Paying for a buyout

In addition to coming up with workable answers to each of these questions, there are other potential obstacles a buyout proposal must overcome. It is likely that any federally-

---

funded buyout would be subject to payment limitations relevant for other agricultural programs. Public perception is another potential stumbling block.

Contracting and buyout uncertainties are part of a long list of other issues that cloud the outlook for tobacco. There are still a number of unanswered questions about the future of the federal tobacco program. Many of the questions are focused on the issue of global price competitiveness. The future of the pool stocks removed in 2000 (from the 1999 disaster crop) that overhang the global market is an added factor of uncertainty. Additional uncertainty stems from recent and anticipated technologies in tobacco production. Progress continues on curing research to reduce tobacco specific nitrosamines and other carcinogens and also on genetically modified tobaccos that may produce a re-

duced-risk tobacco product. At least one major manufacturer has indicated interest in FDA regulation of manufactured tobacco products. Questions remain about the long-term impacts of FDA regulations on the production of the leaf input. Work continues on new uses for tobaccos, including biopharmaceuticals and industrial uses. While these demands are still quite small, they may play a more significant role in the future. Finally, litigation against tobacco manufacturers, for health as well as anti-trust claims, adds more uncertainty to the mix.

While the multitude of diverse issues surrounding tobacco production will certainly affect the future structure of tobacco in Tennessee, tobacco is expected to remain an important enterprise for many Tennessee farmers and for the state's economy.