APAC Agricultural Policy Analysis Center
The University of Tennessee

PolicyPennings by Dr. Daryll E. Ray

Tobacco quota buyout

Last week's column provided an overview of several agriculture-related provisions that were included in the American Jobs Creation Act, the corporate tax reform legislation that passed Congress just moments before their adjournment last week and is now headed to the President's desk. During floor debate on the bill, one lawmaker described the measure as a Christmas tree laden with gleaming ornaments: the add-ons designed to broaden support for the complex measure. For tobacco farmers in the Southeast, the much-anticipated and long awaited - albeit controversial - tobacco quota buyout included in the legislation was the bright shining star crowning the tree.

Attempts to push the tobacco buyout through Congress in the tax reform measure did not take Washington by surprise. The first generation buyout proposal was introduced more than 7 years ago during debate on the comprehensive tobacco settlement between states and major cigarette manufacturers. That first major push failed when the tobacco settlement legislation topped the $500 billion mark and participating manufacturers backed away, finally settling separately with states for more than $200 billion in 1998.

At that time, there was only limited support for the tobacco buyout among quota owners and growers. But things got worse for tobacco farmers. Much worse. Much, much worse. Since 1997, the amount of tobacco that farmers were able to grow and market under the federal quota program has been cut by more than half, with another cut as large as 30% expected for next year. Not only was production slashed, but profitability on the remaining production declined as a major cost of production, the cost of obtaining the quota or rights to market the crop, skyrocketed.

To illustrate the severity of the economic woes, an average burley tobacco farmer in Tennessee may have produced 10,000 pounds of tobacco on 5 acres in 1997. The value of the quota that he was required to own or lease was about 8 to 10 cents per pound, compared to a market price above $1.80 per pound. This farmer could have reasonably expected to pocket $8,000 to $9,000 from his year of work. Fast forward to 2004. This same farmer's 10,000 pounds of quota shrank to 4,200 pounds. And the quota rights now costs him upwards of $0.60 per pound. With a market price near $2.00 per pound, this farmer could reasonably expect his profits to range from a few hundred dollars to $1,000 for his year of work.

Under the federal tobacco program, the situation was not expected to improve, only worsen. The irony of the tobacco story is that the same federal tobacco supply control and price support program that was largely credited with the high level of profitability and stability in the tobacco market since 1938 was largely to blame for the hasty demise. The structure of the program has prevented U.S. producers from reacting efficiently to increasing competition from lower-price foreign competitors with improving quality leaf. Rapid introduction of direct contracting, combined with increasing health concerns, taxes, and legal challenges have further strained the effectiveness of the federal tobacco program.

Since the late 1990s, the handwriting on the wall has become clear to most tobacco farmers: the federal tobacco program is broken and there is no easy fix. As the economic reality facing tobacco farmers set in, support for a tobacco quota buyout and policy transition strengthened.

Since the late 1990s, there have been too many versions of "a" tobacco quota buyout introduced to keep track of. Previous generations of "a" buyout have included various payment levels and post-buyout production programs and safety nets, some linked to legislation granting the Food and Drug Administration the authority to regulate manufactured tobacco products and some not.

Tobacco farmers pinned their hopes on buyout after buyout that failed to materialize. Following the fate of the buyout has been a roller coaster ride, to put it mildly. By mid-summer, two separate versions of a tobacco buyout emerged in the FSC/ETI corporate tax reform packages put forward by the House and Senate, and once again the roller coaster hit a new high. Through the magic of black-box politics (feel free to substitute your own favorite terms here), the ride was over as a favorable compromise was reached on "the" tobacco buyout.

The tobacco quota buyout, which will become official when the American Jobs Creation Act is signed by the President, terminates the federal tobacco quota and price support programs. It provides $9.6 billion in total compensation and transition payments to tobacco quota owners and active growers. Quota owner payments are $7 per pound multiplied by 2002 basic quota. Grower payments are $3 per pound multiplied by 2002 effective quota. An additional $0.5 billion is included to compensate USDA for losses incurred in the disposal of pool stocks, bringing the total cost of the buyout to $10.1 billion. The buyout is funded entirely by assessments on tobacco product manufacturers and importers. Quota owner and grower payments are to be made in 10 equal annual installments, 2005-2014.

Phase II payments that most tobacco farmers were receiving (expected to be over $2 billion through 2010) will end with passage of the buyout. There are not any provisions included that would provide a post-buyout safety net for tobacco growers or geographic restrictions on future production or FDA authority over manufactured tobacco products. Going further than the peanut buyout, the tobacco quota buyout will be an historic transition to a market without government intervention, subsidies or supports. I guess we just thought the roller coaster ride ended when the buyout passed.

This column was written by Kelly Tiller, Assistant Professor with the Agricultural Policy Analysis Center. More detailed information about the tobacco quota buyout is available from the Tobacco Buyout section of APAC's website: http://www.agpolicy.org/tobquota.html. Daryll E. Ray holds the Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee, and is the Director of the UT's Agricultural Policy Analysis Center. (865) 974-7407; Fax: (865) 974-7298; dray@utk.edu; http://agpolicy.org.

Originally published in *MidAmerica Farmer Grower*, Vol. 21, No. 43, October 23, 2004
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