1999 Tobacco Situation and Outlook

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BEFORE

The Master Settlement Agreement

• Agreement Reached June 1997 To Settle State Claims At $316 Billion

• Required Congressional Approval

• Congressional Version (McCain Bill) Exceeded $500 Billion And Failed To Reach A Senate Vote In June 1998

• 4 States Settled Suits Independently Totaling More Than $40 Billion (FL, MS, TX, MN)
Master Settlement Agreement
Master Settlement Agreement

- Agreement Reached November 16, 1998 Between 4 Largest Manufacturers And 46 States In Settlement Of State Medicaid Suits
- Manufacturers Projected To Pay $206 Billion Over 25 Years
- Payments Tied To Demand For Cigarettes And Inflation
- Controversy Over Federal Claim To Medicaid Share, Now Resolved
- Payments Go To General Fund In Each State, States Independently Allocate Funds, No Restrictions On Spending
- First Payments Expected In June 2000
Expected Tobacco Settlement Receipts Through 2025

Florida, Mississippi, and Texas settled individually with cigarette manufacturers prior to the Master Settlement Agreement.
Expected Annual Settlement Payments Through 2025

Florida, Mississippi, and Texas settled individually with cigarette manufacturers prior to the Master Settlement Agreement
Virginia

Plans For Phase I Money

- $180 Million In 2000
- 50% Of All Funds To Tobacco Indemnification & Community Revitalization Fund
- Fund Provides Direct Compensation For Lost Quota (Based on 1996-98 Average Quota)
- Compensation Estimated At $1.2 Billion Through 2015
- Funds Also Used For Research And Community Development To “Reduce Tobacco Dependency”
Virginia

Plans For Phase I Money

• 10% Of All Payments Go To The VA Tobacco Settlement Fund To Reduce Youth Access To Tobacco

• Control Of Remaining 40% Of Funds Is Retained By Legislature For Annual Appropriation

• Legislation Passed Unanimously In Just Over One Month’s Time (Passed 2/26/99)
North Carolina

Plans For Phase I Money

- $206 Million In 2000
- Legislation Passed In March 1999 Allocating Settlement Payments Among 3 Nonprofit Funds
- 25% To A Tobacco Grower Trust To Compensate For Economic Losses (Primarily Quota Loss)
- 25% To A Health Trust For Unspecified Health Issues
North Carolina

Plans For Phase I Money

- 50% To Tobacco Foundation To Provide Assistance To Tobacco-Dependent Communities

- House Passed Bill To Front-End Load Tobacco Farmer And Health Trusts (45% Each For First 6 Years) And Direct Foundation Payments (10% Of Total Payments) To Labor Development For Tobacco Related Industries

- Senate Not Likely To Act This Year
Kentucky

Ag’s Proposal For Phase I Money

- $155 Million In 2000
- No Legislation To Date, Appointed Committees Are Preparing Recommendations For Governor
- Agriculture Committee Recommended $138 Million Plan ($85 Million In 2000)
- Plan Calls For Strengthening Ag Through Target Funding
  - Forage & Livestock
  - Horticulture
  - Rural Dev’t
  - Env’l Compliance
  - Biotechnology
  - Marketing & Promotion
  - Research & Education
  - Venture Capital Fund
Tennessee & South Carolina

Undecided About Phase I Spending

- TN To Receive $215 Million, SC To Receive $104 Million In 2000
- No Legislation To Date, Will Consider In January
- Some Interest In Allocating Portion To Agriculture
- Agriculture And Health Leaders In Each State Have Been Meeting To Discuss Common Ground Approach
Phase I In Other Southern States

- **West Virginia**: Funding Public Employees' Insurance Account, Medicaid, Capital Construction
- **Alabama**: Most Of Early Payments Will Go To “Children First” Program
- **Louisiana**: Most Of Early Payments Go To Balancing Budget, November Vote On Establishing Millennium Trust
- **Georgia**: Initial Payments Likely To Go To Creating A Department Of Community Health, Interest In Funding Rural Development
- **Florida**: Some Interest In Allocating Some Money To Farmers
- **Arkansas, Missouri**: No Decisions Yet
Phase II Of The Settlement
Phase II Of The Settlement

- Manufacturers Agreed To Pay $5.15 Billion Over 12 Years To Tobacco Producing States
- Monies Must Be Used To Compensate Tobacco Growers And Quota Owners For Economic Losses Resulting From The Settlement
- Only Cigarette Tobaccos Eligible (Primarily Burley And Flue-Cured)
- Allocation Of Funds Among States Based On 1998 Quota
- State Boards Determine Allocation Among Growers, Owners, Tenants, And Lessees And Payment Basis
Expected Phase II Payments, 1999 - 2010

- NC: $2,000
- KY: $1,750
- TN: $1,500
- SC: $1,250
- VA: $1,000
- GA: $750
- OH + IN + FL + MO + WV + AL: $500

Millions of Dollars
North Carolina

**Plans For Phase II Money**

- North Carolina To Receive $144 Million In 1999
- Half To Tobacco Farmers, Half To Quota Owners
- Payment Is On Lost Quota In 1999 ($0.68 Per Pound) For Flue-Cured Quota Owners And Growers And Burley Quota Owners
- Burley Growers Receive $0.32 Per Pound For Actual Marketings
Kentucky Plans For Phase II Money

- Kentucky To Receive $113 Million In 1999
- One Third Each To Quota Owners, Growing Farms, Growers/Tenants
- Payments To Growing Farms And Tenants Based On Average Of Marketings And Effective Quota
- Quota Owner Compensation Based On 1998 Basic Quota
Tennessee

Plans For Phase II Money

- Tennessee To Receive $29 Million In 1999
- 80% Allocated To Growers, 20% Allocated To Quota Owners
- Payments Based On Actual Marketings In 1998
- Board Searching For Firm To Administer And Implement Plan
South Carolina

Plans For Phase II Money

- South Carolina To Receive $26 Million In 1999
- 50/50 Split Of Payments Between Growers And Quota Owners
- Payments Based On 1998 Basic Quota
- Producers To Further Divide Payments With Tenants In Some Cases
Virginia

Plans For Phase II Money

• $25 Million In 1999

• Board Has Recently Been Appointed, Controversy Over Composition Of The Board

• Board Must Identify Farmers And Quota Holders Potentially Eligible For Payment By October 1

• Georgia: Growers And Quota Owners Will Evenly Split $22 Million in 1999
Implications Of Phase II

- Not A Quota Buyout ($20 Bil. Versus $5.15 Bil.)
- Basing Payments On Previous Crop Year’s Arrangements Could Bid Payments Into Rental/Lease Rates Or Affect Subsequent Share Arrangements
- Allocations Are Revisited By State Boards Annually
- Existence Of Phase II Could Affect Potential For Phase I Money To Go To Agriculture
Summary: Outlook for Burley

- Expect Further Quota Reductions In 2000, Following 36% Decline Since 1997 To Historical Low
- Production In 1999 Expected Near 1998 Level Due To Relatively High Effective Quota, Intensifies Pressures On Supply And Program
- Projected Continuation Of Decline In Domestic And Export Demand
- No-Net Cost Tripled In 1999, Growers Pay $0.03/Pound
- Depending On Late Season Conditions, Significant Pounds Of 1999 Crop Could Go Under Loan
Basic And Effective Burley Quotas

Million Pounds

Summary: Outlook for Flue-Cured

- Expect further quota reductions in 2000, following 32% quota cut since 1997 to historical low.
- Acreage and production down significantly, quota rental rates continue to rise.
- Demand expected to continue to decline.
- Projected that 10% of 1999 crop could go under loan, further pressuring quotas and the program.
Change in Cigarette Average Retail Prices Since January 1998

- $3.00
- $2.75
- $2.50
- $2.25
- $2.00
- $1.75
- $1.50
- $1.25
- $1.00
- $0.75
- $0.50
- $0.25
- $0.00

- August 1999
- November 1998
- August 1998
- May 1998
- April 1998
- January 1998
Pressures On The Tobacco Program
Tobacco Program Pressure Points

- Politics
  - By Design, Program Does Not Protect Against Quota Instability
  - Quota Transfer Restrictions Induce Inefficiencies As Production Cannot Move To The Lowest Cost Areas
- Continued Uncertainty
Political Pressure Mounting

• 1996 Farm Bill Eliminated Most Other Supply Control And Price Support Programs

• Anti Government Intervention Mood In Washington, Diminished Some By Current Farm Crisis

• USDA Pays Administrative Costs ($16 Million/Year) And Crop Insurance Subsidies ($48 Million/Year)

• Phase II Of Master Settlement Agreement Pays Quota Holders And Growers $5 Billion Over 12 Years, Viewed By Some As “Buyout” Of Program
Tobacco Program Pressure Points

- Politics

- By Design, Program Does Not Protect Against Quota Instability
  - Quota Transfer Restrictions Induce Inefficiencies As Production Cannot Move To The Lowest Cost Areas
  - Continued Uncertainty
Impacts Differ By Tobacco Type

- Both Domestic And Export Demand For Burley Tobacco Are More Inelastic Than For Flue-Cured Tobacco
- Implies That Burley Quota Owners Have More Potential To Garner Economic Rents From Program Than Flue-Cured Quota Owners
- Growers Owning (Renting) Quota For A Large Proportion Of Their Production Have More (Less) Incentive To Keep Program
- Burley Areas May Be More Resistant To Giving Up Program
Tobacco Program Pressure Points

- Politics
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Tobacco Program Pressure Points

• Politics

• By Design, Program Does Not Protect Against Quota Instability

• Quota Transfer Restrictions Induce Inefficiencies As Production Cannot Move To The Lowest Cost Areas

• Continued Uncertainty
Uncertainty Overhangs Market

- Justice Department Intention To File Federal Medicaid Suit Against Manufacturers
- Future Ruling On FDA Authority To Regulate Manufactured Tobacco Products
- Contracting Proposal By Philip Morris
- Further Quota Cuts
- Depressed Markets, Declining Demand