

Is a Tobacco Buyout on the Horizon?

For the past two columns, we've been talking about tobacco: first an introduction to the federal tobacco program and the role it has played in sustaining a large number of family farms in the Southeast for generations and then a litany of the problems conspiring to bring about the demise of the federal tobacco program. In this last column in the tobacco series, I again draw upon the work of APAC economist, Dr. Kelly Tiller, to outline some of the directions tobacco may be heading.

Under the weight of problems threatening the future of tobacco production, a Presidential Commission was established in late 2000 to examine the challenges facing tobacco growers and their communities and recommend solutions. In 2001, the Commission concluded that tobacco farmers are indeed suffering devastating economic losses and that the outlook for their crop isn't very promising. Key in their conclusions was recognition that the situation they're in today has resulted in large part from the confines of the federal tobacco program in place since the 1930s (which, ironically, is the same factor to which most attribute the success and profitability of tobacco crops over the years). The Commission recognized conflict in federal policy that fosters economic dependence on tobacco income and simultaneously discourages tobacco product use because of health concerns.

The solution? The Commission recommended a comprehensive overhaul of tobacco-related policy including (1) replacing the tobacco quota system with a production permit system; (2) compensating quota owners for the loss of the quota asset and tobacco growers for costs of transitioning to a new system (a quota buyout); (3) federal regulation (FDA authority) over manufactured tobacco products; (4) investment in economic and agricultural development in transitioning tobacco communities and investment in state tobacco prevention and health education programs.

But the price tag is hefty, even by the standards of veteran observers of current farm bill debate: \$15 billion. The Commission recommended paying for the tobacco bailout and restructuring package with a \$0.17 per pack increase in the federal cigarette excise tax (which is currently \$0.39 per pack). Such a suggestion has been unpopular, to put it mildly.

While no formal actions have resulted from the recommendations of the Commission, it's not the only game in tobacco town. Ah, the plot thickens. Since the release of the Commission report, talk of a tobacco buyout has reached a frenzy level. Growers, quota owners, and tobacco and agriculture organizations have been frantically rushing to and fro meetings—some public, some behind closed doors—to come up with a unified plan. Various pieces of buyout legislation have been introduced by Representative Hill, Representatives Burr and Davis, and most recently, Representative McIntyre. Most industry watchers expect the big guns to be fired when anticipated buyout legislation is submitted by Senators Helms and McConnell.

To table the funding question for a bit, there are still a number of other issues that any buyout legislation will have to address. A biggie is the payment rate. The most common numbers tossed about have been payments of \$8/lb for the owner of the quota and \$2-\$4/lb for the grower of the quota. Other questions involve the marketing year(s) on which payments would be based, the number of years over which payments would be spread, tax treatment of buyout payments, and subsection to payment limits. Another big sticking point has been provisions for a future tobacco supply control and price support program, without quota assets.

Assuming all the details are resolved satisfactorily, where's the cash spigot? The most likely source is major cigarette manufacturers, or indirectly, consumers through a user fee added to the price of each pack of cigarettes. Industry leader Philip Morris has linked support for a tobacco quota buyout—and the user fee—to Food and Drug Administration (FDA) regulation over tobacco products (with specific mention that FDA authority would not extend to the farm). To some, yoking a tobacco quota buyout and FDA regulation over cigarettes seems unnatural. But FDA regulation is likely inevitable. By influencing the way FDA regulation is structured, the cigarette industry may be able to get a version of FDA regulation that is less restrictive than what may eventually result from public health's FDA efforts, and it may even insulate them from future legal battles. It bears noting that other major tobacco manufacturers oppose FDA regulation. They claim that as proposed, it would give Philip Morris, which already dominates the tobacco industry, unfair advantages in capturing market share for reduced risk cigarette products—the wave of the future—and would be much harder for manufacturers in second place and below to meet strict manufacturing practices required by FDA.

Just this month, class action status was granted on a suit filed by a group of tobacco growers in 2000 claiming that tobacco manufacturers and leaf buyers conspired to destroy the federal tobacco program and replace it with a system under full control of tobacco manufacturers. This development has the potential to put manufacturer efforts to fund a buyout on fast track to settle what potentially could be an ugly suit by the farmers they have claimed to be helping all along.

Despite the heightened interest and recent progress, it's probably too early for tobacco growers and quota owners to start checking the mailbox for buyout payments, though a buyout of some form seems more likely today than ever before. With or without sweeping changes, lower demand and profit margins will likely push many small tobacco growers out of the market and concentrate production on fewer, larger farms in lower marginal cost areas where direct contracts with manufacturers are the dominant marketing strategy. Many tobacco growers fear that the days are numbered for the "golden" leaf that has been such a dominant force in shaping the culture and economy of an entire region for generations.