US Farmer

Price Supports

END OF AN ERA

Price supports may be next to go, farmers fear

BY JAMES H. WALLACE, THE COURIER-JOURNAL

Sales of tobacco, like this one this month at the Lucas-Hussey Tobacco Warehouse in Louisville, brought Kentucky farmers million this season. But Philip Morris' plan to close its plant makes some pessimistic about the industry's future.

Some think program is target of cost cutting

By JOE WARD
The Courier-Journal

The U.S. tobacco industry is consolidating its domestic operations while investing heavily overseas, leading Kentucky's tobacco farmers to fear they will be the next casualty of the push for greater efficiency and maximum profits.

A shock wave ripped through the state's 45,000 tobacco farms last week after Philip Morris dropped a bomb on Louisville, announcing it will eliminate 1,400 jobs and close its cigarette plant by the end of next year.

Rod Kuegel, a Daviess County tobacco farmer and president of the Lexington-based Burley Tobacco Growers Cooperative Association, thinks the next battle will be fought at the farmers' doorstep over the federal tobacco price-support program.

For 60 years the program has kept the supply of tobacco in balance with demand and has made tobacco the country's most profitable crop. But Kuegel said he thinks the tobacco program could come under attack as early as next month. He said it's only logical that the cigarette companies will want to reduce costs by paying farmers less for their tobacco.

"Philip Morris told me they'll have a major announcement in the middle of March," Kuegel said. "I communicated that burley farmers would do whatever it took to preserve the program and support prices."

When asked about Kuegel's concerns, company spokesman Rusty Chevront released this statement: "Philip Morris fully supports the U.S. tobacco farmer and the tobacco program."

But Kentucky farmers, who sold $900 million in tobacco this season, and others in the tobacco industry say the planned closing of Louisville's Philip Morris plant is just the latest sign of sweeping change in the tobacco industry that farmers will be unlikely to escape.

Even Kuegel acknowledges that the widening gap between the price of U.S. and foreign-

See FARMERS
Page 13, col. 1, this section

Farmers fear price supports may come under new attack

Continued from Page One

grown tobacco makes it difficult for the companies not to shift production overseas.

U.S. BURLEY, the type of tobacco most grown in Kentucky, brings an average of $1.90 a pound. "It's not realistic to assume we'll be able to sell tobacco to a plant in Warsaw when the companies can buy it in Africa or South America for 50 or 60 cents a pound," Kuegel said.

It is largely the federal price-support system that keeps the U.S. price high.

And that is a problem in the view of James Starkey, senior vice president of Richmond, Va.-based Universal Leaf Tobacco Co., who said the price-support program has other problems as well.

Starkey said he knows of no industry plan to campaign against price supports. But he said it is clear that "the program has affected the competitive position of U.S. leaf in the world market, and the only way to reverse the downward trend in export business is to make needed changes."

Farmers don't deny that the system has problems, but they don't like talk about changing it. The program, which was created in the 1930s to protect growers from large price swings, is good to farmers. It assures them a predictable, profitable price, and shields them to a degree from dependence on the mercies of a few powerful companies.

WITHOUT the program, Woodford County tobacco farmer Curtis Congleton said, tobacco would likely be "vertically integrated," as chicken and hog production have become, with companies offering contracts to producers, under conditions and prices set by the companies.

With the tobacco program, companies must bid at least a penny a pound above a support price set by the government. If they don't, a farmer-owned co-op buys the tobacco, and the government cuts production until the companies are forced to buy tobacco from the co-op to meet manufacturing needs.

"Any time we lose production of cigarettes, we'll lose the opportunity to produce the tobacco."

Rod Kuegel, Burley Tobacco Growers Cooperative

The downward trend in export business that Starkey mentioned, though, is a worry for farmers. U.S. Department of Agriculture statistics show that domestic consumption of cigarettes fell from 563 billion in 1988 to fewer than 470 billion last year.

Cigarette exports, which rose from 118.5 billion in 1988 to almost 244 billion in 1996, looked like they might offset lost domestic sales. But they started dropping as well and were down to 201 billion last year. Exports of unmanufactured tobacco also have dropped, from 109.9 million pounds in 1994 to 77.8 million in 1998.

Starkey said U.S. burley costs a third more than burley grown in Africa or South America, where farmers with a much lower standard of living are increasingly eager to grow more.

WORLD TOBACCO buyers have long been willing to pay more for U.S. burley, he said, because it has special qualities that are in demand in cigarettes — due, he said, to Kentucky's "unique combination of soils, climate and curing weather, and knowledge and experience of the growers."

But he said Brazil produces burley second best to that from the United States, and it recently devalued its currency, further widening the price gap. "At some point it becomes uneconomic for a manufacturer to pay the increasing premium," he said.

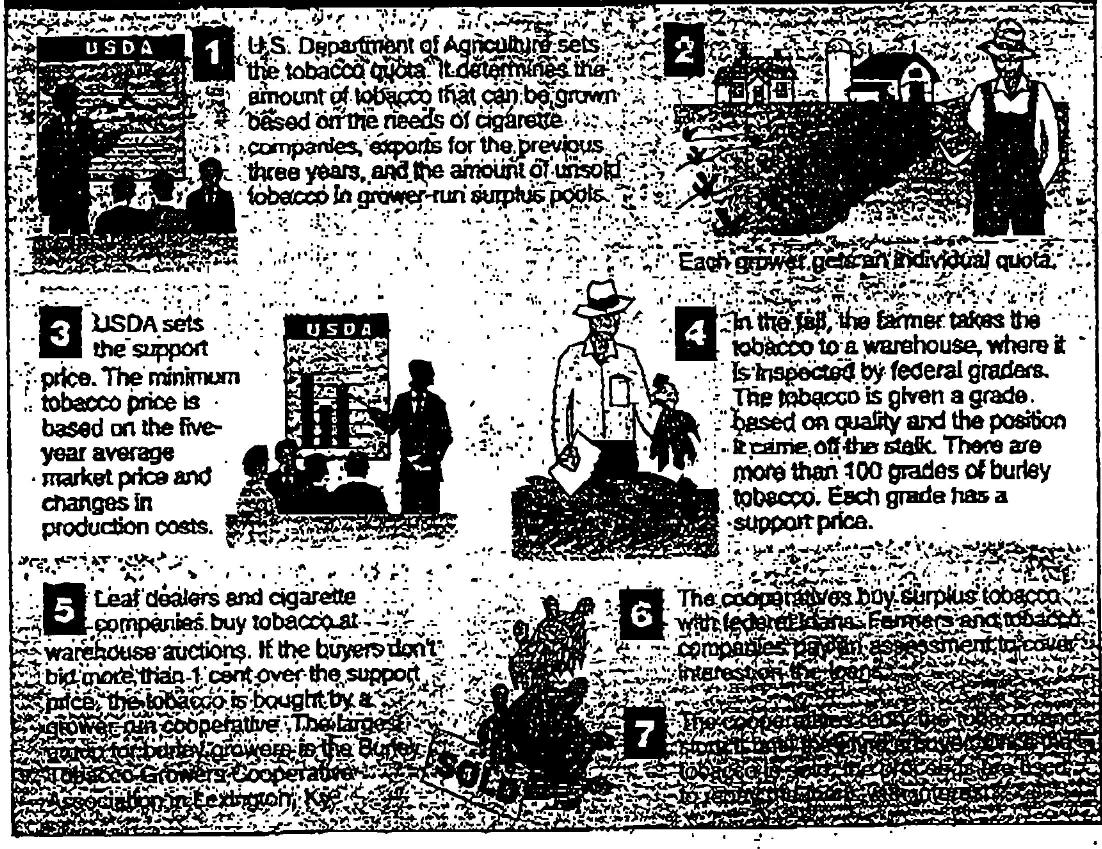
And Kuegel noted that economic crises in many countries have made quality much less important than price.

Another problem with the price-support program, Starkey said, is that it generates production inefficiencies that make higher prices necessary. Under the program, tobacco is grown under quotas that are tied to the counties where tobacco was being produced when the program began in the 1930s. A quota is the amount of tobacco the federal government will let a farmer grow.

In practice, large tobacco producers — such as Kuegel and Congleton — lease quotas from holders who don't want to raise the tobacco. But they sometimes end up dragging equipment and labor across county lines, when it would be more efficient to grow the crop in one place.

And sometimes the lease price adds significantly to a producer's costs — notably in years like 1999, when the government cuts the overall quota and big farmers have to scramble for limited production rights. "I'm in a battle right now for lease prices," Congleton said.

HOW THE TOBACCO PRICE-SUPPORT SYSTEM WORKS



LIKE STARKEY, many farmers would like to correct such problems. What keeps them from doing it is mostly Congress. It would take congressional action to alter the program, and tobacco has enemies in Congress who would like to do away with it completely, for anti-smoking reasons.

Starkey conceded that — especially since Kentucky's Wendell Ford left the Senate at the end of last year after years as tobacco's strongest champion in Washington — trying to fix the program might well mean its demise.

The political threats to tobacco are great now, but Ford said farmers have astutely enlisted the support of some health groups to keep the price-support program in place, because it keeps the price of cigarettes high, reducing smoking.

FORD SAID he doesn't think the cigarette companies want to buck both groups.

But Congleton said he would not be surprised to see a continued drop in quota until the government eventually buys the farmers out. He thinks that's what the companies really want.

Meanwhile, Philip Morris and other companies continue to put money into plants overseas. Tobacco Reporter, a trade journal, reported in December that Philip Morris during the 1990s has invested more than $807 million in the Czech Republic, Germany, Hungary, Kazakhstan, Lithuania, Ukraine, Russia and Poland. It said those facilities had an annual production capacity of more than 116 billion cigarettes.

THE TRADE publication noted a recent $155 million Philip Morris expenditure to upgrade a 57-year-old plant in Switzerland, where it said the company makes 21 billion to 22 billion cigarettes and ships them to about 60 countries.

Philip Morris spokesman Cheuvront said last week that foreign production had no bearing on the company's decision to close the Louisville plant, though he said 27 percent of cigarettes made in Louisville are for export.

Bobby Hines, president of Tobacco Workers union Local 16, which represents many of the 1,400 workers who will lose their jobs when the plant closes, said workers were told Philip Morris has been required to make cigarettes in some of the countries where it sells them.

Kuegel said he doesn't think the companies are likely to make cigarettes overseas and sell them in the United States. But he said the days of U.S. manufacture of cigarettes for export are numbered.

"And any time we lose production of cigarettes, we'll lose the opportunity to produce the tobacco," he said.