Tobacco-farmers- Robb
— GW

KEY ISSUES INVOLVING FLUE-CURED TOBACCO

- **What does the President want a grower's provision to achieve?**
  The goal of a tobacco growers' provision in comprehensive tobacco legislation is to make growers and their communities "whole" in the face of a significant change in federal tobacco policy.

- **What's the likely effect of comprehensive tobacco legislation?**
  The legislation is likely to decrease demand significantly for manufactured tobacco products by, among other things, substantially increasing the price of a pack of cigarettes and initiating a large anti-smoking advertising effort. The effect of that legislation will determine the demand for tobacco products in the United States.

- **What would result if comprehensive tobacco legislation is enacted without a change in current tobacco production policy?**
  If the consumption of tobacco products declines, there will be a substantial negative impact on tobacco growers and their communities, absent a change in tobacco policy. For flue-cured growers, the result of such a substantial decline in demand would be catastrophic unless major changes are made. The Congressional Research Service estimates that a $1.50 increase in the cost of a pack of cigarettes would cause a 30% decline in consumption. A flue-cured grower who grew 100 pounds would now only have 70 pounds to grow. In order to fill the barns and make fixed payments, the grower would go into the marketplace to acquire another 30 pounds of quota, so the grower would be back to growing 100 pounds. Other growers will also be in the marketplace, trying to acquire more quota. Quota-holders, facing an increasing demand for their asset, will start to charge higher rents, following the law of supply and demand. As rents increased, so would the price of a pound of flue-cured tobacco because the price of the product would reflect this increasing cost of production. As the price increased, the manufacturers would increase their purchases of lower-priced foreign tobacco, causing the demand for domestic tobacco to decrease even further. As domestic tobacco is displaced by imports in the U.S. market, quota declines even further, pushing the costs of acquiring quota yet higher, until the domestic flue-cured market disappears altogether.

- **How does supply affect demand?**
  Supply does not create demand. Supply follows demand. The provisions of comprehensive tobacco legislation will create a reduced level of demand. That demand will be supplied by a certain amount of tobacco. If it doesn't come from domestic producers, it will come from foreign producers. There is no public policy reason for preferring foreign producers, and in fact there are at least two public policy reasons not to. First, displacing U.S. producers harms tobacco growers and their communities, which the President has stated explicitly he does not want to do. Second, it is more difficult to regulate and control foreign production, where harmful pesticides, genetically-altered tobacco, and other dangerous practices can more easily go undetected.

- **What is the effect of international competition on domestic tobacco production?**
  According to the Congressional Research Service, "U.S. cigarettes now contain only about

tobacco from accumulating liquid value. This is done by retiring the old quota system by compensating owners for the value of the asset, estimated to be $8/pound. A new supply-limiting system would then be instituted, where the right to grow would not be an asset that could be bought or sold or rented. The right to grow would be given to an actual grower and would limit the amount that grower could produce. If the grower decided to leave the business, the right to grow would be surrendered to the issuing authority, and the right to grow that amount would be redistributed to other actual growers. By eliminating the equity value of quota, it eliminates the costs associated with acquiring quota, and makes domestic tobacco more competitive. Making U.S. tobacco more competitive will maintain a level of production and prevent an increase in the amount of foreign tobacco consumed in the United States.

characteristics are built into the price of domestic tobacco. There is that element of the price which represents the restrictions on supply, and there is that element of the price which represents the equity value of the asset. The equity value of the quota, or the value of the asset, can roughly be determined by the amount for which it rents. In flue-cured, that amount is about 40¢/pound, and for burley that amount is about 25¢/pound. The remainder of the $1.75/pound price of domestic flue-cured is the world price plus the intrinsic value of a limitation on supply, which increases the price.

- **What is the appropriate level of price support?**
  Under the present formula, the price support level includes the cost of quota equity as part of a farmer's cost of production. If that element of the cost of production is eliminated, that cost should be removed from the price support level. The aim of the tobacco production policy with regard to price is to set it at the "right" price. If the domestic price support level is set too high, manufacturers will simply shift to lower priced imported tobacco to save money. This creates a kind of "windfall" for the companies and it is occurring today because the price support level for flue-cured is too high. That is why imports are increasing their market share in the United States. If the domestic price support level is set too low, domestic farmers will not be able to make enough to cover their costs, forcing them out of business and again shifting company purchases to lower priced imported tobacco. The "right" price is one that is low enough to encourage companies to buy domestic tobacco rather than cheaper imports, but above the world price and sufficient to give producers a return on their labor.

- **Should quota holders be compensated at different levels depending on whether they rent out their quota or grow their quota?**
  Quota is an asset that has value. The value of that asset does not vary depending on the intentions of the individual who owns it. The value is what the value is. Some quota holders rent out their quota to growers, who produce the tobacco. Other quota holders grow the tobacco themselves. Once the value of the asset has been determined, all asset holders should receive the same value.

- **What price will recipients of the new, non-transferable production-limiting permits pay?**
  Those actual growers who receive a permit to grow a limited amount of tobacco will be required to pay in the form of lowered price support. If the grower used to rent quota, the price the grower receives for his product will be reduced by the amount the grower used to pay to rent the quota from a quota holder. If the grower used to be a quota holder, then the price the grower receives for his product will be reduced by the extra profit he realized by not having to pay quota rents.

- **How can flue-cured tobacco growers maintain a level of production if domestic consumption of tobacco products decline as a result of comprehensive tobacco legislation?**
  The solution to maintaining a level of production for U.S. flue-cured tobacco growers is to remove the "equity value," or the "asset value," of quota. This is done by eliminating the current quota system, and reinstating a new system that prevents the right to grow

to make domestic tobacco more price competitive.

- **Why retain a supply-limiting program?**

The public health community has recognized the need to retain a supply-limiting program. William Broome of the American Heart Association recently stated, "we feel a strong case can be made for maintaining some sort of price and production controls." Among the reasons listed, one was that without a program, "more tobacco would be grown overseas, with less control over additives, pesticides and other unregulated practices which might be allowed in producing and manufacturing tobacco overseas." Even if the equity value of quota is removed from the cost of flue-cured tobacco, a supply-limiting program still keeps the price of tobacco higher than the world price. In addition, limiting the supply of tobacco prevents "fence row to fence row" production of low price tobacco in the United States. It also prevents production from shifting dramatically from the areas where tobacco is currently grown to other areas of the country where cheap tobacco could be grown all year long. Such a shift would devastate existing tobacco communities. A supply-limiting program also gives growers some leverage against the companies. There are essentially four buyers of tobacco, and without a program that sets a floor on the price of tobacco, the companies would deal individually with each small grower, dictating price and making the grower highly dependent on the companies. The American Heart Association in fact has stated that "economic and political links would be strengthened between the tobacco industry and tobacco growers" if a supply-limiting program were eliminated. The argument for eliminating the supply-limiting program is a philosophical one of the natural benefits of a free market. The aim of a free market system, however, is to insure that the consumer efficiently gets the lowest-cost product. The entire aim of comprehensive tobacco legislation is to increase the costs to consumers, not decrease them. Eliminating a tobacco program to achieve a free market system would destroy existing communities and the livelihood of existing farmers without realizing the goal of a free market: to increase efficiency and lower costs to the consumer. There is no other agricultural product that faces this unique situation where the government's policy is to increase the costs to the consumer, not decrease them.

- **What is quota?**

While quota is referred to in "pounds," it actually represents a proportionate share a quota-holder has in the total market of tobacco. Every year, a determination is made about how much tobacco should be grown in the following year to reflect the anticipated demand for tobacco. As tobacco demand declines, so does the amount of tobacco a quota-holder can grow by a proportionate amount. For example, if demand declines ten percent next year, the total quota for tobacco would fall from 1.5 billion pounds this year to 1.35 billion pounds next year. A person who holds 100 pounds of quota this year would then hold 90 pounds of quota next year.

- **What makes up the value of quota?**

Quota has both intrinsic and liquid value. While these characteristics are interrelated, they are separable. Growers rent quota for its intrinsic value, which is the value of having a program that restricts supply and raises price. The amount a quota-holder receives in rent, or upon the sale of the quota asset, represents its liquid value. Both

60% domestic tobacco while they once contained more than 90%--a reflection of the declining competitiveness of U.S.-grown tobacco." U.S. growers are being displaced in the U.S. market by cheaper imports. As CRS noted, cigarette manufacturers "have been increasing the use of less expensive foreign tobacco and decreasing the use of more costly U.S.-grown tobacco." One of the questions presented by the comprehensive tobacco settlement is whether the demand for tobacco in the U.S.--whatever that demand may be following enactment of comprehensive tobacco legislation--will be supplied by U.S. growers or foreign growers.

- **What's the difference between burley tobacco growers and flue-cured tobacco growers?**
  Burley tobacco growers tend to be small producers who grow tobacco to supplement their incomes. Burley tobacco growing is not capital-intensive, meaning there is not much in the way of fixed costs. As quota declines, a burley tobacco grower grows fewer pounds and his supplemental income declines. He can be made whole by giving him the profit from the lost pounds he no longer can grow. Burley growers also tend to be price sensitive, wanting to get the highest possible price for each pound of burley they grow, since they put much of their own physical labor in the planting and harvesting of each pound. Burley growers are able to sell at higher prices because the quality of U.S. burley has not yet been matched by foreign-grown burley tobacco, so it can command a price higher than the world price.

  Flue-cured tobacco growers tend to grow larger amounts of tobacco as their primary source of income. Flue-cured tobacco growing is capital-intensive: it is more mechanized and the flue-curing barns are more sophisticated and expensive than burley barns. A flue-cured tobacco grower therefore has high fixed costs, such as payments on loans used to buy the equipment necessary for growing flue-cured tobacco. As quota declines, the amount of production declines. He then has equipment that is under-utilized but which still has the same fixed costs. If he can't afford to make payments on the equipment or the barns, he is forced to sell them (at a reduced cost since there is now an oversupply of equipment needed to tend a declining amount of production) and the farmer no longer has the means to make a livelihood on the farm. For these reasons, flue-cured growers tend to be sensitive to the level of production.

- **Do the differences between burley and flue-cured growers mean that they need different approaches to be made "whole?"**
  Flue-cured growers are primarily interested in maintaining a level of production, while burley growers tend to be interested in maintaining a level of income. Given the differing needs of these growers, it may make sense to have separate programs that address the particular needs of each.

- **Why can't we require the tobacco manufacturers to buy domestic tobacco?**
  A simple solution for maintaining a level of production for U.S. tobacco is to require companies to use a certain amount of domestic tobacco. "Domestic content" laws, however, have been ruled illegal under GATT. So if we cannot force manufacturers to buy domestic tobacco, we must entice them to do so. The only way to accomplish that is

Tobacco-
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TOBACCO TESTIMONY 3/24

Changes in Bold: p. 6 changes

There are more than 124,000 farms engaged in the production of tobacco, and we recognize that a significant reduction in smoking in the United States could curtail a **vital** source of income for many families and communities. **That is why the President made protection of tobacco farmers and their communities one of the five key elements of his plan for comprehensive tobacco legislation. The President has made clear ~~several times~~ that he will support legislation only if it provides farmers with a secure financial future. We believe there are very promising efforts underway in Congress to ensure that farmers and their communities are protected. In particular, Senator Ford and his colleagues on this Committee, Senators Hollings and Frist, have taken a leadership role in crafting legislation to protect farmers and the Administration strongly supports your effort to build a bipartisan consensus. We also look forward to being able to support the product of your work in this area.**

A good many commentators in this debate have implied that combating teen smoking involved a zero-sum choice -- between protecting the health of children on the one hand, and protecting the economic well-being of farmers and their communities on the other. The President has explicitly rejected this false choice. So have the coalition for public health and tobacco farming organizations that last week endorsed a set of principles with which both groups could agree. **Among the organizations agreeing to the principles are the Burley Tobacco Growers Cooperative, the Flue-Cured Tobacco Stabilization Corporation, the American Heart Association, the American Cancer Society, and the Campaign for Tobacco Free Kids.** Let there be no doubt: we are determined that one important use of the funds raised by higher prices on cigarettes will be the provision of ....

TOBACCO FARM BACKGROUND

Background:

Since the 1930s, tobacco prices have been supported and stabilized by the federal government's commodity support program. The tobacco program operates through a combination of marketing quotas, which limit supply, and no-net-cost tobacco loans, which help to balance supply with demand. There are two main types of tobacco -- flue-cured and burley. Flue-cured is common in North Carolina, while burley is more popular in Kentucky.

The settlement agreement with the Attorneys General did not outline a plan to compensate farmers for the diminished domestic tobacco sales that might result from comprehensive legislation. The President, however, made protecting tobacco farmers and their communities one of the five key elements of his plan for comprehensive tobacco legislation.

Status in Congress:

Three types of legislative approaches have been discussed. First, Senator Lugar has proposed legislation that would quickly "buy-out" quota owners from the governmental system at approximately $8 a pound. In Senator Lugar's plan, tobacco prices would then be subject to the free market. Second, Senator Ford has proposed legislation that would maintain the current quota system, while also compensating farmers (up to $8 per pound) for the difference between the prices they would have enjoyed without legislation and the diminished prices they may experience. Senator Ford's bill also includes a $500 million a year transition fund for communities. Finally, Senator Robb has proposed legislation that would combine elements of both of the above approaches. He wants to buy-out farmers, but replace the quota system with a production control system based on licenses. Unlike quotas, licenses would be given only to those who actually grew tobacco and could not be bought or rented.

No consensus has yet emerged in the tobacco growing community as to the preferred approach. Senator Ford's proposal, the LEAF Act, appeals most to burley growers like those in Kentucky who have small farms and want to continue the quota program. Senator Robb's approach has gained some support from flue-cured farmers (based mainly in North Carolina and Virginia) who believe the buy-out and license system better fits more capital-intensive flue-cured production. Senator Lugar's approach has not attracted widespread support; even tobacco-state senators like McConnell who philosophically favor this approach probably will not come out for it publicly.

Senators Ford and Robb have discussed a compromise bill that would treat flue-cured and burley tobacco differently. Under this approach, flue-cured growers would be bought-out with those continuing to grow tobacco operating under a license system like that supported by Senator Robb; by contrast, burley growers would remain subject to the quota system, with compensation for the decreased price of tobacco, as favored by Senator Ford. One major issue separating Ford and Robb at this point is Robb's belief that there should be a decrease in the legislatively-set price of flue-cured tobacco so it can be more competitive internationally. Senator Ford has opposed this proposal, and the Administration concerns that decreasing the price of tobacco may not be compatible with public health goals.

The Administration has encouraged the effort by Senator Ford to develop a compromise proposal. Many members of Congress -- in both the House and Senate -- are also looking to a Ford-brokered Senate compromise proposal that all tobacco-state members could sign on to.

Q. Does the Administration support continuing controls on tobacco production, the quota program, as part of comprehensive tobacco control legislation? The President has stated that he supported the tobacco program in the past.

A. The President has consistently made clear his commitment to tobacco farmers and his belief that we need to protect them and their communities. He has noted that any changes to our tobacco policy should not come at the economic expense of farming families and communities. One method of protecting these farmers is continuing production control programs, as legislation such as the LEAF Act supported by Senators Ford, Hollings, and Frist does. And the Administration agrees that controls on production can be one element of a system that meets the President's five principles and protects farmers and their communities economic well-being.

Q. Does the President have a proposal to help tobacco farmers and their communities?

A. As I stated in my testimony, the President has made clear that he will support legislation only if it provides farmers with a secure financial future. We are hopeful that a consensus is being built in this area, and believe there are very promising efforts underway in Congress to ensure that farmers and their communities are protected. In particular, Senator Ford and his colleagues on this Committee, Senators Hollings and Frist, have taken an important role in crafting legislation to protect farmers and the Administration strongly supports your effort to build a bipartisan consensus. We also look forward to being able to support the product of your work in this area.

tobacco fairness
/ Gw

U.S. Department of Agriculture

DATE: MAR - 5 1998

FROM: Dallas Smith DRS
Deputy Under Secretary
Farm and Foreign Agricultural
Services

TO: Tom Freeman
The White House
Domestic Policy Office

Per your request, attached is a paper on options on the Robb Tobacco Bill.

If you have further questions, please contact me at (202) 720-7107.

Attachment

OPTIONS ON THE ROBB TOBACCO BILL

The Robb Bill (S.1582) would provide quota holders $8.00 per pound and producers $2.00 per pound over a 5-year period. There is a concern that some individuals would receive both the $8.00 per pound as a quota holder and $2.00 per pound transition payment as an active tobacco producer. How could this "so called" double-dipping be eliminated? The following options are presented as possibilities:

Options:

1. Place an absolute cap of $8.00 per pound for every quota holder regardless of whether they produced tobacco.
2. Pay every quota holder $6.00 per pound initially. Then, quota holders who did not produce any or some part of their quota in the base period could declare such and receive an additional $2.00 per pound. Those who produced tobacco could receive $2.00 per pound in transition assistance.
3. All quota holders would receive $8.00 per pound for quota owned. After all quota holder payments have been completed, the quota would then be placed in a pool. To redistribute the quota, all quota holder-producer quota would have to be purchased at $2.00 per pound (original owner would have first rights). All quota holder-producer quota not purchased would be factored back to all non-owner producers of record. All producers would be eligible for the $2.00 per pound transition payment.

Best choice

Under the Robb Bill, price supports in 1999 would be equal to -- (1) The simple average price received by producers of the kind of tobacco during the immediately preceding 5 marketing years for the kind of tobacco, less (2) the average return to quota for 1994 through 1998 crops of the kind of tobacco. In addition to this 5-year rolling average concept, the following options are presented as possibilities:

Best choice 2

OPTIONS ON THE ROBB TOBACCO BILL

1.80 select

Options:

1. Determine the cost-of-production for the base years and subtract quota rental and /or lease costs. This figure would determine the base. For succeeding years, calculate a cost-of-production index for the current year and compare it with a similar cost-of-production index during the prior year. The amount of change (up or down) would be added or subtracted from the previous year's support to obtain the current year's support.

   Cost of production

2. Use the cost-of-production concept specified above and increase or decrease the previous year's support level by between 50 percent to 100 percent of the change in the cost-of-production index based on the level of U.S. stocks of the specific kind of tobacco, level of world supplies, prices in major competitor countries, and projected demand for U.S. leaf.
3. Use the same cost-of-production concept specified above and permit 50 percent to 75 percent of the annual change in the prices paid (parity) index to go into effect based on U.S. stocks levels, world supplies, prices in competitors countries and projected demand.
4. Use the same cost-of-production concept specified above and add a target price concept. Perhaps the target price could be set at 75 percent of the cost-of-production (excluding rent) with transition payments to make up the difference if prices fall below the target level.
5. Tie the original price support level to a "so-called" world price "adjusted for quality and location values". Then adjust this price up or down based on changes in a cost of production formula. Periodically adjust this price support level, if needed, to the world price of tobacco. Note: The world price of tobacco is not definitive or readily determinable. However, a working "world price" could probably be agreed upon.

s:/tpas/drafts/rbs1582

tobacco
- fairness
- SW

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COMMENTS: Info on the Robb Tobacco Bill (S.1582)

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A New Proposal Regarding Tobacco

- *Summary*: Because government action is about to erode the value of quota, there would be a buy-out of all existing quota at $8/lb. A privatized tobacco program limiting supply would be reinstituted, providing growers with a license to grow tobacco based on historical average production for that grower. To provide long-term economic security in tobacco communities, $250 million would be provided annually for economic development. Finally, a transition payment would be offered to growers as the system changes from its present form to the new one.

- *Quota Equity Buy-out*: The proposal would give quota owners $8/pound for their quota. The funds would be paid out in five annual installments of $1.60/pound based on the three-year average (1995-1997) of their basic quota. To avoid serious tax consequences, which would be the government giving with one hand and taking away with the other, the funds could be placed in a tax-deferred 401(k)-type plan, or used tax-free to reduce debt associated with tobacco farming. This program would convert existing quota into cash, it would terminate the existing tobacco quota system, and a new program would be instituted to give growers the right to grow tobacco through the issuance of licenses.

- *New Tobacco Program*: Once all the quota has been bought out, the new system would grant licenses to actual tobacco producers. These licenses would go to all producers, whether they were quota holders, tenant farmers or quota leasees. There would be no significant cost associated with acquiring the licenses. These licenses would give the farmer the right to continue growing tobacco, but unlike the previous system that right could not be bought or sold or leased. In other words, that license, unlike quota, would not be a liquid asset. If the grower decided to stop exercising the right to produce granted by the license, the license would be surrendered to the issuing authority, which could then reissue the license to another grower. By wringing the value out of quota through the buy-out, producers will no longer face the expense of leasing or buying quota. Once that cost of operation is eliminated--which represents about 40¢ of the price of a pound of flue-cured tobacco--the producer can be more competitive, both here and overseas. And by being more competitive, the decline in quota will not be as steep, and growers will not suffer the severe dislocation that a sudden drop in quota would create, whether that drop is caused by decreased demand or increased costs of production.

- *Economic Development*: In addition, $250 million annually would be allocated for economic development in tobacco dependent communities. The funds could be used for specific purposes, such as improving the quality of all levels of education in the region, promoting tourism through natural resource protection, constructing advanced manufacturing centers, industrial parks, water and sewer facilities and transportation improvements, establishing small business incubators, and installing high technology infrastructure improvements.

- *Transition*: To make sure that current producers can survive until this new system is implemented over the five-year buy-out period, the proposal contemplates giving a minimum of income protection during this period by providing transition payments of 40¢/lb. to growers over 5 years, based on historic production.

Section-by-Section Summary of The "Tobacco Market Transition Act"

These are the highlights of each section of the legislation:

Section 1. **Table of Contents.**

Section 2. **Definitions.**

This section includes the definition of an "active tobacco producer" (who will be eligible to receive transition payments and a license to grow tobacco) and a "quota holder" (who will be eligible for the quota asset buyout). An "active tobacco producer" is a person who was the actual producer of tobacco planted in 1997. A "quota holder" is a person who owned a farm on January 1, 1998 which carried a tobacco farm marketing quota or farm acreage allotment.

Section 3. **Purposes.**

Section 101. **Tobacco Community Revitalization Trust Fund.**

This section establishes a trust fund which will compensate quota holders, make transition payments to growers, fund the privatized tobacco production limiting program, pay for tobacco crop insurance, and provide community development grants. From the funds generated as a result of comprehensive tobacco legislation, the trust fund would receive $3.5 billion for the first five years, and $265 million each succeeding year.

Section 201. **Compensation to Quota Holders for Loss of Tobacco Quota Asset Value.**

A quota holder would receive $8/pound based on the average tobacco farm marketing quota established for the 1995 through 1997 marketing years for the farm owned by the quota holder on January 1, 1998. The payments would be made in 5 equal annual installments beginning in 1999.

Section 202. **Transition Payments for Active Tobacco Producers.**

Tobacco producers who grew tobacco in 1997 would be eligible to receive 40¢/pound for five years based on the average number of pounds of tobacco quota established for a farm for the 1995 through 1997 marketing years for which the grower was the actual producer of tobacco on the farm.

Section 203. **Tobacco Loan Associations.**

To extricate the federal government from the tobacco program and assist tobacco loan associations make the transition to the privatized program, this section forgives various loans made to the associations by the Department of Agriculture, transfers title to the loan associations of tobacco held in inventory by the Department of Agriculture, and transfers to the loan associations the funds held in the No Net Cost Tobacco Fund and the No Net Cost Tobacco Account held on behalf of the associations.

Section 204. **Tobacco Community Economic Development Grants.**

The Corporation will award $250 million annually to tobacco-dependent counties to aid community development efforts. The funds can be used for various purposes, including education, small business incubators, technology infrastructure enhancement, transportation improvements and water projects.

Section 205. **Tax Treatment of Tobacco Quota Holder Compensation and Transition Payments.**

Compensation funds to quota holders and transition payments to tobacco producers will not be taxed if placed in a qualified retirement account or if used to retire debt directly associated with tobacco production incurred prior to January 1, 1998

Section 301. **Tobacco Production Control Corporation.**

This section creates the privatized Tobacco Production Control Corporation, which will undertake the duties previously performed by the federal government. These duties will include:

→ Governing the production, marketing, importation, exportation, and consumer quality assurance for each kind of tobacco;
→ Offering crop insurance;
→ Establishing a quality assurance system that provides for the inspection and grading of tobacco marketed in the U.S., determines and describes the physical characteristics of domestic and imported tobacco, and ensures the physical and chemical integrity of domestic and imported tobacco; and
→ Creating a licensing system to limit the production of tobacco, replacing the current quota system. Licenses would be issued by the Corporation at no cost to the producer and no tobacco could be sold without a license. Initially, licenses would be issued to active tobacco producers and would be surrendered to the Corporation if the producer ceases growing tobacco. Licenses could not be sold, leased or transferred except to a licensee's spouse or children actively engaged in the production of tobacco.

Section 302. **Tobacco Loan Associations.**

This section requires the Corporation to enter into agreements with producer-owned loan associations for each kind of tobacco to make price support available, carry out the licensing system, arrange for financing and administration of price supports and handle any domestically produced tobacco received as collateral for a price support loan.

Section 303. **Tobacco Price Support Levels.**

For the 1999 crop year, the price support shall be the simple average price received by producers for the preceding 5 years less the average return to quota for 1994 through 1998 crops. This eliminates from the price of tobacco an amount equal to the previous cost of acquiring quota.

Section 304. **Penalties.**

This section sets forth the penalties for those who sell tobacco without a license or in violation of a license, and for those who purchase tobacco which is not licensed or violates a license.

Section 305. **Program Referenda.**

This section allows producers to vote periodically on whether to retain the new privatized program.

FLOOR STATEMENT OF U.S. SENATOR CHARLES S. ROBB
NOVEMBER 3, 1997

Mr. President, farmers face a great deal of uncertainty. The uncontrollable forces of nature or a volatile market can destroy a farmer's livelihood without warning. When the crops are planted, growers worry about whether they'll be enough rain--or too much; whether supply will be too great or demand too small; whether prices will be too low, or production costs too high. For tobacco growers, these unavoidable concerns were compounded when the tobacco industry and the 40 states' attorneys general unveiled their global settlement of tobacco issues on June 20 of this year. The parties did not address how the settlement would affect America's tobacco growers and their communities, however.

Much has happened since that time. Congressional hearings have been held, legislation has been drafted, and the President has reviewed the global settlement. A common theme runs through these separate actions, and that theme is that tobacco farmers and the families and communities that depend on them should not be punished by comprehensive tobacco legislation. I believe the President said it best when he remarked during his discussion of the tobacco settlement in September that "we have a responsibility to [tobacco growers]. They haven't done anything wrong. They haven't done anything illegal. They're good, hardworking, tax-paying citizens, and they have not caused this problem. And we cannot let them, their families, or their communities just be crippled and broken by this. And, I don't think of the public health community wants to do that . . . We're trying to change America and make everybody whole. And they deserve a chance to have their lives, and be made whole, and to go on with the future as well."

My staff and I have been working for a number of months on a proposal I believe may offer a means of making tobacco growers whole and providing the resources necessary to expand economic opportunities in tobacco-dependent regions. While we have discussed these concepts with various people, I would like to describe it more publicly now so that I can get broader feedback from interested parties. In putting together this proposal, we have talked to tobacco growers, local government officials interested in economic development, agricultural economists and members of the public health community.

To reduce youth smoking, health advocates seek an immediate and substantial increase in the price of tobacco products. If Congress adopts this strategy, it will have a substantial effect throughout the tobacco-growing regions, and I believe we have an obligation to help provide a soft landing for the people who would be affected.

The plan we've developed contains several components. First, it would compensate quota owners for the value of their quota, which is likely to be eroded over time by this government action. Second, it would dismantle the existing federal tobacco program, which has been under annual assault, and reinstitute a privatized supply-limiting program. Third, it would target economic development funds to tobacco-dependent communities, to be used to attract quality jobs and train individuals for them. The effect of these changes, which I will describe in more detail, would be to give quota holders the value of their asset, guarantee that producers retain a program stabilizing the supply and price of tobacco, reduce operating costs to the grower by eliminating the expenses associated with buying or leasing quota, make domestic tobacco more competitive, and provide long-term economic development.

Buy-out of quota asset. Tobacco quota refers to the amount of tobacco that can be produced domestically. Last year, there were 1.5 billion pounds of tobacco quota. Today, quota owned by an individual, which represents the proportion of the total amount of domestic quota an owner has the right to produce, is an asset which can be bought or sold or leased. Its value has accrued over time, and for many in tobacco-producing regions it is the major asset used to pay for retirement. Farmers acquire quota throughout their lives so they can grow tobacco to sustain their families, and then in retirement sell or lease it to others for income. A substantial and immediate increase in the price of tobacco products will decrease demand and will reduce the amount of quota. This erodes the value accrued by quota-holders, as their proportionate share declines with demand. Since so many have invested in this asset, many of whom rely on it for retirement, it is appropriate to compensate for the decline in value caused by a radical change in government policy.

I propose giving quota owners $8/pound for their quota. The funds would be paid out in five annual installments of $1.60/pound based on the three-year average (1995-1997) of their basic quota. To avoid serious tax consequences, which would be the government giving with one hand and taking away with the other, the funds could be placed in a tax-deferred 401(k)-type plan, or used tax-free to reduce debt associated with acquiring the quota. This program would convert existing quota into cash, it would terminate the existing tobacco quota system, and a new program would be instituted to give growers the right to grow tobacco through the issuance of licenses.

New Tobacco Program. It is crucial that we reconstitute some form of supply-limiting tobacco program. Without one, production shifts to large agribusinesses that are encouraged to grow as much tobacco as possible. The price for tobacco would plummet, and many communities where tobacco is now grown would be immediately devastated. A supply-limiting program stabilizes the price of tobacco, so that wild swings don't put small growers out of business, and limits production. While many agricultural commodity programs have moved away from the supply-limiting approach, I believe it is still appropriate in the unique case of tobacco. There is no other farm product where the ultimate goal is to increase the cost to consumers, not decrease it. In addition, the "free market" isn't so free in the tobacco industry, because there are essentially only four buyers who have unparalleled control over the market. To require farmers to contract individually with the few large buyers is to put the farmers at a gross competitive disadvantage.

The new tobacco program should be privatized to the extent possible. No one enjoys the annual uncertainty that follows from constant attempts to end the tobacco program. Growers, who benefit from the program, should be willing to take on the obligation of running it. Once all the quota has been bought out, the new system would grant licenses to actual tobacco producers. These licenses would go to all producers, whether they were quota holders, tenant farmers or quota leasees. There would be no significant cost associated with acquiring the licenses. These licenses would give the farmer the right to continue growing tobacco, but unlike the previous system that right could not be bought or sold or leased. In other words, that license, unlike quota, would not be a liquid asset. If the grower decided to stop exercising the right to produce granted by the license, the license would be surrendered to the issuing authority, which could then reissue the license to another grower. By wringing the value out of quota through the buy-out, producers will no longer face the expense of leasing or buying quota. Once that cost of operation is eliminated--which represents about 40¢ of the price of a pound of flue-cured tobacco--the producer can be more competitive, both here and overseas. And by being more competitive, the decline in quota will not be as steep, and growers will not suffer the severe dislocation that a sudden drop in quota would create, whether that drop is caused by decreased demand or increased costs of production.

I would like to see the creation of a privatized authority that would govern the production, marketing, importation, exportation and consumer quality assurance of U.S. farm produced tobacco. This authority, which I'll call the Tobacco Production Control Corporation, could have a varied membership, and one option would be to have an authority with 21 members. The members would include the Secretary of Agriculture, the Secretary of Health and Human Services, the Administrator of EPA, the U.S. Trade Representative, nine representatives of Tobacco Loan Associations, four rotating representatives of the public health community, one representative from domestic cigarette manufacturers, one representative form the domestic export leaf dealers, one representative from tobacco marketing facilities, one representative from the Tobacco Marketing and Quality Assurance Corporation and one representative from the agriculture department of a tobacco state university.

The Tobacco Loan Associations would be comprised of all licensees of each respective type of tobacco. Initially, licenses would be issued to all tobacco growers based on the three-year average (1995-1997) of tobacco they produced. The Tobacco Loan Associations would issue licenses to control the quantity of tobacco production, and would assure compliance by levying fines. Additionally, they would arrange for financing and administration of price supports, including the right to receive, process, store and sell any U.S. produced tobacco received as collateral for private price support loans.

The Tobacco Marketing and Quality Assurance Corporation would be created to determine and describe the physical characteristics of U.S. farm-produced tobacco and unmanufactured imported tobacco, operate a crop insurance program, and assure the physical and chemical integrity of U.S. produced and imported unmanufactured tobacco. This would insure that the tobacco being used in domestically manufactured tobacco products is of the highest quality and is free from prohibited physical and chemical agents. The Quality Assurance Corporation would consist of a CEO hired by the Tobacco Production Control Corporation and a staff experience in the sampling and analysis of unmanufactured tobacco and capable of collecting data and monitoring tobacco production and consumption information.

These are the elements that could constitute a new tobacco program. Under this proposed program, once the quota holder has received the value of the asset, a new system of regulating the production of tobacco would be created. This approach honors the value of quota, retains the price stabilizing benefits of the tobacco program but eliminates the current costs associated with acquiring quota, making domestic tobacco more competitive in the future. I'd like to acknowledge the insightful contribution of Henry Maxey, a tobacco grower from Pittsylvania County, who first presented this idea to a member of my staff in a meeting a few months ago in the Halifax office of Delegate Ted Bennett. While I've gotten input from an number of people since then, Mr. Maxey should be credited with getting the ball rolling.

Economic Development: I would like to devote $250 million annually for economic diversification in tobacco-dependent communities. Unfortunately, the biggest export in many of the tobacco-growing regions is the children. They leave the area because there aren't enough high quality jobs in the community. Tobacco legislation provides us a unique opportunity to address this situation. The economic development funds should be used for two purposes: attracting quality jobs and training people to fill them.

I believe that economic development activities are best generated from those most familiar with a community's needs. Generally speaking, I believe that economic development funds should go to counties to carry out those activities that best suit their needs. I would envision that the funds would be distributed to localities based on their proportionate share of the amount of tobacco produced annually, which is a rough approximation of how dependent each community is on tobacco income. In order to foster long-range thinking and coordination in the region, the communities should develop and submit economic development plans. In the case where an independent city is surrounded by a tobacco-dependent county, but doesn't itself produce tobacco, representatives from the city should have a voice in the development of the county's economic development plan, due to the economic interdependence of the two independent governments.

In some circumstances, counties have banded together to form regional economic development commissions, like the A.L. Philpott Southside Economic Development Commission in Virginia. In that case, the commission should be given the authority to coordinate the economic development funds, allowing the various counties to benefit from a regional approach. Such an approach would avoid duplicative efforts to provide the same services or attract the same industries as a neighbor in the region, making the funds more effective. When coordinating the economic development investments, the commission will be required to target a certain percentage of the funds to the most tobacco-dependent counties as determined by their proportionate share of the amount of tobacco produced annually. This approach combines regional planning with local investment.

The funds can only be used for specific purposes, such as improving the quality of all levels of education in the region, promoting tourism through natural resource protection, constructing advanced manufacturing centers, industrial parks, water and sewer facilities and transportation improvements, establishing small business incubators, and installing high technology infrastructure improvements. We will need to insure, however, that these funds are not used to reduce the amount of funding that would otherwise be provided by the local, state or federal governments.

Transition. Whenever there is a major shift in a program like the one this proposal contemplates, we need to be concerned about providing a smooth transition. In fact, the uncertainty created by the mere possibility of major tobacco legislation will undoubtedly affect tobacco growers next year, who expect a serious decline in quota because these issues remain unresolved. To make sure that current producers can survive until this new system is implemented over the five-year buy-out period, we should consider giving a minimum of income protection during this period. One option would be to add protections in the event tobacco quota falls by more than 10% from 1997 levels. If that occurs, tobacco producers would be eligible for a $1/pound payment for lost quota from their 1997 level. This is especially important to farmers operating without much margin, as we make the transition to a more competitive marketplace.

Conclusion. I hope that these ideas generate some discussion and ultimately I intend to introduce legislation incorporating these ideas. My purpose is to find a mechanism that recognizes the changes facing the tobacco industry, and provides some degree of certainty to tobacco growers and their communities so that they are not faced with cataclysmic upheaval as a result of those changes. And I look forward to working toward this goal with colleagues who are interested in addressing these challenges.

A New Proposal Regarding Tobacco

- *Summary*: Because government action is about to erode the value of quota, there would be a buy-out of all existing quota at $8/lb. A privatized tobacco program limiting supply would be reinstituted, providing growers with a license to grow tobacco based on historical average production for that grower. To provide long-term economic security in tobacco communities, $250 million would be provided for economic development. Finally, a transition payment would be offered to growers as the system changes from its present form to the new one.

- *Quota Equity Buy-out*: The proposal would give quota owners $8/pound for their quota. The funds would be paid out in five annual installments of $1.60/pound based on the three-year average (1995-1997) of their basic quota. To avoid serious tax consequences, which would be the government giving with one hand and taking away with the other, the funds could be placed in a tax-deferred 401(k)-type plan, or used tax-free to reduce debt associated with tobacco farming. This program would convert existing quota into cash, it would terminate the existing tobacco quota system, and a new program would be instituted to give growers the right to grow tobacco through the issuance of licenses.

- *New Tobacco Program*: Once all the quota has been bought out, the new system would grant licenses to actual tobacco producers. These licenses would go to all producers, whether they were quota holders, tenant farmers or quota leasees. There would be no significant cost associated with acquiring the licenses. These licenses would give the farmer the right to continue growing tobacco, but unlike the previous system that right could not be bought or sold or leased. In other words, that license, unlike quota, would not be a liquid asset. If the grower decided to stop exercising the right to produce granted by the license, the license would be surrendered to the issuing authority, which could then reissue the license to another grower. By wringing the value out of quota through the buy-out, producers will no longer face the expense of leasing or buying quota. Once that cost of operation is eliminated--which represents about 40¢ of the price of a pound of flue-cured tobacco--the producer can be more competitive, both here and overseas. And by being more competitive, the decline in quota will not be as steep, and growers will not suffer the severe dislocation that a sudden drop in quota would create, whether that drop is caused by decreased demand or increased costs of production.

- *Economic Development*: In addition, $250 million annually would be allocated for economic development in tobacco dependent communities. The funds could be used for specific purposes, such as improving the quality of all levels of education in the region, promoting tourism through natural resource protection, constructing advanced manufacturing centers, industrial parks, water and sewer facilities and transportation improvements, establishing small business incubators, and installing high technology infrastructure improvements.

- *Transition*: To make sure that current producers can survive until this new system is implemented over the five-year buy-out period, the proposal contemplates giving a minimum of income protection during this period. One option would be to provide transition payments of 40¢/lb. to growers over 5 years, based on historic production.

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The two problems the public health community has with the Lugar provision are that it takes money from public health programs in the first three years, and allows unlimited production of tobacco in the United States.

To remedy these deficiencies, amend Lugar in the following ways: stretch the payments out over ten years, and institute a system that limits the amount and location of domestic tobacco production. The system to limit production would be privatized.

The effect of this amendment would be to eliminate the current quota system (where quota is treated as an asset), compensate growers within the 16% allocation of the McCain bill, remove federal involvement in tobacco and limit the amount of tobacco production in the United States.

- **Why pay farmers and allow them to grow?**

In flue-cured, the $8/pound that is paid to quota holders represents the value of the equity of quota. Quota is an asset. When the asset is taken, it must be compensated. The Lugar/McConnell provision recognizes this, as does the LEAF Act.

The quota asset is acquired in the marketplace. It can be bought, sold or rented. People who own quota have paid for it, and the substantial change in tobacco policy resulting from this bill will erode the value of that asset. Both the Lugar/McConnell provision and the LEAF Act eliminate the current quota system for flue-cured tobacco. And they both pay these asset holders $8/pound. And they both allow the quota holder to continue growing tobacco, but he no longer owns the quota asset. That has been exchanged for compensation. The difference between the two provisions--with regard to Flue-cured tobacco--is that under Lugar/McConnell, the grower can produce an unlimited amount of tobacco while under LEAF, the amount of tobacco that grower can produce will be restricted.

As for continuing to grow after payment, remember that the payment is to compensate for loss of the asset. It is not a bribe to keep people from growing tobacco.