Transitional Assistance

While the impacts of a declining tobacco industry on the economy as a whole are modest, many individuals, businesses, and communities will face difficult adjustments in the short run. Assistance to affected individuals, businesses, farms, and communities is justified on two counts: (1) compensation for capital losses (of economic rents), and (2) transitional assistance to help individuals and communities make the switch to non-tobacco employment. A buyout of tobacco quotas is an example of compensation for capital losses. Financial assistance for retraining, farm diversification, or economic development programs are examples of transitional assistance.

Legislative proposals for comprehensive tobacco legislation offered in 1998 proposed giving economic development grants to States for agricultural and economic development in tobacco-producing counties. Among the proposals were education grants for tobacco farmers and their dependents, a $500 million worker retraining program for workers employed in manufacturing, wholesaling, or warehousing tobacco; block grants to States for development of agricultural alternatives; on-farm diversification; risk management; and off-farm economic development in tobacco-growing areas. While none of these bills was passed by Congress, several tobacco States are considering spending portions of their tobacco settlement funds on transitional assistance and economic development. North Carolina will set aside 50 percent of funds received from the Phase I tobacco settlement to fund a nonprofit foundation that will assist tobacco communities. An additional 25 percent of settlement funds will go to a trust fund for tobacco growers, allotment holders, and workers in tobacco-related businesses. Virginia also set aside 50 percent of its settlement proceeds for tobacco growers and communities and established a commission to oversee spending of the funds. Other tobacco States may also set aside a large portion of settlement funds for growers, quota owners, and tobacco communities. In addition to Phase I spending, a Phase II settlement provides $5.15 billion for growers and allotment holders to compensate them for declining tobacco purchases resulting from the Phase I settlement. With so much money available, States are carefully considering how to spend it effectively to help growers and communities.

Discussion of transitional assistance can be aided by listing the various groups and their likely responses to a decline in the tobacco industry. We will briefly discuss the types of assistance relevant to each category. Different levels of Government, private foundations, financial institutions, or private business are already providing some assistance. The groups in need of assistance can be broadly categorized as in table 14 using a scheme originally developed by Reaves and Purcell.

Table 14—Adjustment strategies and assistance needs for tobacco farms, workers, and communities

Group	Strategy	Needs
Farmers, manufacturing and other workers	Stay in tobacco; expand operation, raise productivity; bear increased risk (if tobacco program is eliminated)	Financing for land and capital acquisition; research on alternative uses; risk-reducing mechanisms; market and price information; market power
	Identify and market alternative crop or commodity	Technical and marketing information; financing
	Seek alternative off-farm employment	Rural job creation; training and skill development; job information and search skills
	Retire	Financial planning
Tobacco communities	Encourage new agricultural enterprises (attract processor; open farmers market; encourage agricultural tourism; promote local purchases by retailers and restaurants)	Assistance in market evaluation; grants/loans for farmers market facility, advertising, and promotion
	Develop or attract nonfarm industry	Grants or loans for infrastructure development and business start-up; aid for local schools and colleges

Source: ERS modification of framework developed by Reaves and Purcell.

Helping Farmers Who Stay in Tobacco

Many farmers will choose to continue growing tobacco as their primary activity. Age, size, and efficiency of the operation, financial status, availability of alternatives, and preferences will influence the decision. Specifically, if the tobacco program were eliminated, low-cost producers with capacity for expansion in the Coastal Plain, Pee Dee-Lumber River region, Georgia, Florida, and central and western Kentucky would be most likely to stay in the industry. In the short run (5-10 years), many less efficient farms with low debt and poor alternatives to tobacco may also continue growing tobacco until their assets are worn out. Farmers who remain in tobacco farming could be assisted in several ways. Research that develops better production technologies could improve farm efficiency. Additional research on alternative uses for tobacco plants as a protein source or for pharmaceutical use could boost demand for the crop if viable products emerge. Those who expand their tobacco acreage will need access to new capital for acquisition of land, facilities, and technology. In the absence of a tobacco program, farmers will face greater fluctuations and uncertainty in prices and returns, and many observers are concerned that greater market power of the relatively few purchasers of tobacco leaf would place farmers at a disadvantage. Many in the industry anticipate that farmers would begin producing on contract for manufacturers (as is done in some foreign leaf markets) if the tobacco program were eliminated. Farmers may need means of reducing revenue risk, such as revenue insurance, forward contracts, or hedging. Growers will also need information about prices and market conditions. Oversight of market relations between growers and buyers and assistance in evaluation of grower contracts may be warranted.

Nontobacco Agriculture

Growing alternative or supplemental crops is another strategy where tobacco farmers may need assistance. This strategy is often referred to as "diversification," or "supplementation." Most tobacco farms are already diversified, particularly flue-cured farms. Earlier in this report, we noted that 44 percent of burley farms reported selling only tobacco, while 31 percent had sales from two commodities, 15 percent sold three, and 21 percent sold four or more (table 8). Flue-cured farms were more diversified. Only 18 percent of flue-cured farms sold only tobacco, while 42 percent reported sales from 4 or more different enterprises in 1996.

In a 1995 survey of 529 tobacco farmers by Altman et al., half indicated that they were interested in trying other on-farm ventures to supplement tobacco income, and 58 percent said they had tried to learn about on-farm alternatives to tobacco. Land-grant universities, extension, State departments of agriculture, and non-profit foundations have been assisting farmers in identifying and adopting viable alternatives that can provide high (and stable) returns per acre. Other field crops generally do not satisfy this requirement, but cotton has been a popular alternative in the Coastal Plain area. North Carolina has successfully diversified its agriculture by expanding its hog and poultry industries. The poultry industry is expanding in Kentucky as well. In looking for tobacco alternatives, much attention has been given to other high-value per acre, labor-intensive enterprises, such as vegetables, specialty crops, and direct-marketing strategies. Our analysis of FCRS/ARMS data found that very few tobacco farms had vegetable, fruit, or horticultural enterprises in 1995-96. There were not enough sample farms with these enterprises to provide statistically reliable results (see table 9).

Development of a local market for alternative enterprises is a key to success. When Altman et al. asked farmers about barriers to supplementing tobacco income, the leading response (along with "nothing is as profitable as tobacco") was "few processing plants connecting farmers to consumers." Similarly, 60 percent cited "no places to sell new products." The volume of produce grown in a tobacco area is frequently too small to interest wholesalers or grocers. A coordinated effort may be needed to bring in a processing plant or develop other markets in conjunction with an alternative crop. There have been a number of unsuccessful efforts to develop farmers markets, cooperatives, and relationships with local grocery chains, so efforts should proceed cautiously. Some observers have credited North Carolina's active agricultural marketing program for the State's recent development of a highly diversified agricultural sector.

Tobacco diversification initiatives may need assistance in carefully evaluating the economic impacts on local commodity markets. When tobacco farmers switch to alternatives, the increased supply of the alternative commodity can push down local prices, resulting in lower returns than expected and harming local farmers who already grow the commodity. For example, vegetable growers have opposed proposals to assist tobacco farmers in switching to vegetables, because this would push down prices and the assistance would give an unfair advantage to the former tobacco growers. The small market for specialty and niche crops, such as ginseng, ostriches, and Asian vegetables, can become quickly saturated, driving down prices and returns.

Another barrier to tobacco supplementation or diversification frequently identified by farmers is "lack of capital available for new businesses," cited by 60 percent in the Altman et al. study. This is relevant for farmers seeking to start a new on-farm enterprise, as well as those seeking to start a nonfarm business. Studies of rural capital markets have found that capital is generally available, but bankers tend to be cautious about lending money for new, unfamiliar enterprises. Lenders look for a well-thought-out business plan that includes careful assessment of prospects for processing and marketing alternative products before they will grant credit. That means that the lack of outlets for alternative products can reinforce the lack of capital access. It should also be pointed out that new, risky ventures are generally financed with equity capital, rather than debt. While borrowed funds may be accessible in rural areas, venture capital for small on-farm diversification projects may be difficult to access.

Economic Development Strategies

Communities can take a number of approaches to developing nontobacco agriculture. Most strategies target high-value-per-acre activities that include on-farm processing or provision of services (pick-your-own, agricultural tourism, on-farm recreation), or marketing strategies that yield a high margin to the grower (farmers markets, roadside stands, direct sales to retailers or restaurants, community-supported agricultural cooperatives).[15] Local governments or organizations can aid in market development by working to attract a processing plant to the community, acquiring grants or loans for construction of a farmers market facility, or coordinating and/or sponsoring advertising or promotion in nearby urban areas. Local organizations may also aid the local dissemination of market and technical information developed by Federal agencies or land-grant universities.

Cities where tobacco manufacturing is important have successfully developed other industries, most prominently, banking and medical services and research, that have reduced their dependence on tobacco. Textile, apparel, and other low-wage, low-skill manufacturing have historically been important in many of the smaller communities where tobacco is grown, but those industries are declining. The region has long relied on attracting manufacturing facilities as an approach to economic development. Many experts in economic development criticize this approach as too costly in State and local tax concessions and infrastructure, and argue instead that encouraging start-up of small, locally owned businesses leads to more sustainable development and places less fiscal pressure on local and State governments. Many communities have built industrial parks to attract business, while others have relied on small business incubators. Nonagricultural development may require investment in infrastructure (telecommunications, highways, water, and sewer) and in local educational institutions, as well as aid to new businesses. Assistance in the form of guaranteed and direct loans, grants, and technical assistance is available through the U.S. Department of Agriculture's Rural Business-Cooperative Service and Rural Utilities Service, the U.S. Department of Housing and Urban Development's Community Development Block Grants, the U.S. Department of Commerce's Economic Development Administration, the Small Business Administration, the Tennessee Valley Authority, and the Appalachian Regional Commission.

Economic Development Assistance

Some farmers and other tobacco workers may seek off-farm jobs as an alternative to tobacco. Obviously, creating new jobs locally can encourage this strategy, but people displaced from tobacco work may need upgraded skills to qualify for jobs. Farmers and workers may need help in developing skills and education through community colleges, trade schools, GED course work, or other training programs. This assistance will be most needed in the most tobacco-dependent counties of central Kentucky and the Piedmont flue-cured region. Most tobacco communities have access to community or technical colleges, many of which have programs linked with specific local industries to develop skills needed by those industries. Improved skills and education may also qualify tobacco growers and workers for jobs outside their community. Proposals directed at retraining and education have included education grants to tobacco farm families and job retraining assistance modeled on the Department of Labor's Trade Adjustment Assistance Program for displaced workers.

[15]Gale (Februrary 1997) provides more details about direct farm-marketing strategies.

The U.S. Department of Commerce sponsors a trade adjustment assistance program that provides technical assistance to businesses, which could be a model for assisting tobacco-related businesses. Another model for assisting economic development in tobacco communities is the Community Adjustment and Investment Program. This program provides credit through a partnership between USDA's Rural Business-Cooperative Service and the North American Development Bank to businesses in U.S. communities that have experienced significant job losses due to changing trade patterns with Canada and Mexico after passage of the North American Free Trade Agreement.

Some tobacco-reliant communities may respond to the loss of tobacco income by seeking to develop other agricultural enterprises. Others may target nonfarm development, and many will pursue both strategies. A host of governmental and other organizations could potentially play a role in development of tobacco communities, including State and local governments, USDA's Rural Development mission area, Federal economic development agencies, HUD's Community Development Block Grants, Cooperative Extension, universities, community and technical colleges, private foundations, and other alliances of farmers and businesses. Many of the entities listed above are already assisting tobacco communities. Some groups are working together in formal and informal alliances to plan for transition to nontobacco development. In 1998, a coalition of growers, public health interests, and State government representatives recommended the establishment of a new Federal commission, two regional farming community foundations, and a network of tobacco community councils to oversee tobacco transition assistance. Such a structure might bring more unity and synergy to tobacco community development efforts. Alternatively, USDA's Rural Development mission area might foster the development of a less formal regional compact. This has been done in other parts of the country to address region-specific problems. One example is the Northwest Timber Adjustment Initiative, which provides funding and technical assistance to timber-dependent communities in the Pacific Northwest that have been affected by changes in Federal land use policies. Other examples are the Delta Compact and the Colonias Initiative, which bring together governments and nongovernmental organizations to address the needs of poor areas in the Lower Mississippi Delta and the region along the Mexican border.