

Appendix 1: The Tobacco Farm Program

The basic provisions of the current Tobacco Program that governs flue-cured and burley tobacco were implemented with the 1938 Agricultural Adjustment Act to ensure a steady and reliable supply of high-quality tobacco while minimizing income fluctuations for growers. Growers of each type of tobacco vote in a referendum every 3 years to determine their participation in the program. An affirmative vote makes growers subject to USDA rules and regulations applicable to that type of tobacco. Since its inception, flue-cured growers and burley growers have participated in the program every year but one. The program has two basic elements: (1) a support price that sets an effective minimum price, and (2) quotas that restrict the amount of tobacco that may be marketed. The program tends to enhance income to growers. It also stabilizes the market so that prices, income, and production fluctuate much less for tobacco than they do for other agricultural commodities.

After harvesting and curing their tobacco, farmers transport their leaf to a warehouse to be sold. The leaf is set out on the warehouse floor, where each pile or bale is inspected and given a grade. The grade determines the loan rate (support price) it is eligible for, since each grade has a different rate.¹ The auctioneer and buyers move across the warehouse floor, bidding on individual lots of leaf. Tobacco that fails to sell at a price exceeding its grade loan rate is either retained by the farmer or turned over to the cooperative in exchange for a nonrecourse loan equal to the grade loan rate less applicable fees. Grower-owned cooperatives purchase, manage, and store the tobacco until it can be resold. This process is funded by loans from the USDA's Commodity Credit Corporation. The loans are repaid, with interest, when the tobacco is sold. The No-Net-Cost provision, introduced in 1982, requires that all costs of the tobacco program be borne equally by tobacco growers and buyers. Each year, growers and buyers are charged an assessment to cover the costs incurred by the cooperatives in carrying out the price support program. The only costs to the government are modest administrative expenses.

¹The grade, or quality, is determined by the leaf's placement on the stalk, color, and other characteristics.

The annual flue-cured and burley price support is the level for the preceding year adjusted by changes in the 5-year moving average of prices (two-thirds weight) and the cost of production index (one-third weight).² The Secretary of Agriculture can change the support price between 65 and 100 percent of the calculated adjustment. The price support level for each type of tobacco is applied to each grade within that type. Grade loan rates are based on recent trends in market prices, loan holdings, and the shares of particular grades received under loan. The weighted average of various loan rates must equal the overall support level for each kind of tobacco. Other tobacco types have slightly different procedures for setting price supports.

The quota is the quantity of tobacco leaf that can be marketed by a grower during a given marketing year. The total quota for a given type of tobacco is set and then divided among individual growers in proportion to the quota they either own or rent. Quotas are set in such a way as to balance supply with anticipated demand and to prevent build-up of large stocks by the tobacco cooperatives. The quota is set by a formula that includes the manufacturers' purchase intentions, plus the 3-year average exports, plus an adjustment to maintain a preset stock level. The resulting figure can then be raised or lowered up to 3 percent by the Secretary of Agriculture. After the quota is set, it is adjusted by each grower over or under marketings from previous years. Brown (1995) points out that changes in demand for tobacco tend to be reflected by changes in quota (due to the inclusion of purchaser intentions and stock levels in the formula), while the price support tends to be more rigid from year to year, reflecting rising production costs.

Quotas were originally set based on historical production in the 1930's. Burley growers can lease or transfer quota to other growers, but quotas cannot be transferred across county lines (except for burley tobacco in Tennessee). Flue-cured growers cannot lease and transfer quota. Quotas may also be transferred by (1) selling or renting land which has been assigned a tobacco allotment or quota, (2) leasing quota to a grower in the same county as the original allotment (except for flue-cured), or (3) selling the quota to an active tobacco grower in the same county.

²Costs include general variable costs, but exclude costs of land, quota, risk, overhead, management, marketing contributions or assessments, and other costs not directly related to tobacco production.