

TOBACCO IN TRANSITION: AN OVERVIEW OF SIXTY-SIX YEARS OF PARTNERSHIP BETWEEN PRODUCERS, PROCESSORS AND POLITICIANS

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On October 22, 2004, President George W. Bush signed the Jobs Creation Act of 2004, legislation that included the Fair and Equitable Tobacco Reform Act which established the Tobacco Transition Payment Program, better known as the tobacco quota buyout. The passage of this controversial legislation, which ended marketing quotas and support prices for tobacco that had been in place since 1938, is expected to fundamentally and permanently change tobacco production in the United States. The purpose of this essay is to provide insights into the establishment and operation of the Tobacco Program and to identify and analyze events leading to its demise.

On October 22, 2004, President George W. Bush signed the American Jobs Creation Act of 2004, legislation that included the Fair and Equitable Tobacco Reform Act, which established the Tobacco Transition Payment Program (TTPP), better known as the tobacco quota buyout. The passage of this controversial legislation ended the tobacco marketing quota and price support loan programs authorized by Title Three of the Agricultural Adjustment Act of 1938 and the Agricultural Act of 1949. The TTPP was designed to provide payments over a ten-year period to quota holders and producers of quota tobacco to help them make the transition from the federally-regulated program that had provided producers a safety net under auction prices and manufacturers a stable crop of raw material for several decades.¹

Foundation Farm Policy

The Agricultural Adjustment Act (AAA) of 1938, which established the Tobacco Program, was one of several New Deal initiatives inspired by President Franklin D. Roosevelt to move the U.S. economy out of the Great Depression. Although the Great Depression provided the impetus for passage of the AAA of 1938, the legislation was designed to address recurring problems related to the overproduction of, and resulting low prices for agricultural commodities in general and other challenges that had plagued the tobacco industry since colonial days.² The AAA of 1938, as it was widely referenced, was a synthesis of former legislation, including the Agricultural Marketing Act of 1929, which established the Federal Farm Board, and the Agricultural Adjustment Act of 1933. The Federal Farm Board was designed to promote the effective merchandising of agricultural commodities through a system of producer-owned and controlled cooperative associations and thereby aid in the prevention and controlling of surpluses. However, as the Depression deepened and the farmer's share of the consumer's dollar shrunk from 40 percent in the 1920s to 32 percent in 1932, it became apparent that the Federal Farm Board did not contain the mechanism to solve the problem of overproduction and low prices.³ The AAA of 1933 was designed, inter-alia, to re-establish prices to farmers at a level that would give agricultural commodities purchasing power with respect to articles farmers bought in the designated base period of August 1909 to July 1914.⁴ The base period, usually designated as 1910-1914, was chosen because it was a period of general prosperity for American Agriculture. Not only were farm prices high relative to the cost of inputs, but also farm income was high relative to the non-farm sector. Thus, the pre-World War I period was often referred to as the Golden Age of Agriculture, although the prosperity enjoyed by the general farm economy was not shared by all sectors, particularly the tobacco industry.⁵

The AAA of 1933 was the first legislation to give a legal definition to parity prices and to widely institute price supports and production controls, policy tools that would become permanent fixtures in the tobacco program. Parity price was defined as the price that today would give a unit of a commodity the same purchasing power as it had in 1910-1914. For example, "if a bushel of wheat would buy a pair of overalls in 1910-1914, then to be at parity, a bushel of wheat should be priced so as to buy a pair of overalls today."⁶ The parity price was calculated by dividing the product of the current market price for a unit of the commodity and the index of prices paid during the 1910-1914 base period by one hundred.⁷ With the mechanism in place for determining the parity price, tobacco acreage allotments were the means to limit production to bring supply into equilibrium with demand at the established parity price. Although the AAA of 1933 had the potential to become a workable tobacco program, the Act was ruled unconstitutional by the Supreme Court in 1936 in the *Hoosac Mills Case*.⁸ Outlawing the AAA of 1933 left tobacco farmers without an orderly production and marketing program and left the tobacco industry facing problems predating the Great Depression and even the Golden Age of Agriculture.

Persistent Problems in the Tobacco Industry

Problems associated with the production, processing, peddling and policing of tobacco developed soon after John Rolfe began growing tobacco in 1612 in Jamestown, Virginia for export to England. Commercial production of tobacco quickly led to the establishment of tobacco warehouses which stored, displayed, sold and exported leaf tobacco. These warehouses soon became a source of tax revenue, and warehouse receipts emerged as an official substitute for currency in Virginia in 1783 and Kentucky in 1792.⁹ Despite increasing government regulations, droughts and floods, and punitive taxes from all levels of government and profiteers within and outside the industry, the tobacco industry continued to grow. After the Civil War ended in 1865, tobacco production and warehousing quickly spread to ten states. In 1872, federal law requiring tobacco farmers to furnish, under oath, a correct statement of all leaf sales and a tax of six cents per pound on natural leaf in its cured state would have a profound impact on the tobacco industry. The new federal laws put warehouses, which had tried to develop markets with independent auctioneers that were fair to both buyers and sellers, into the awkward and negative roles of informers and tax collectors. In addition, leaf buyers in 1880 began encouraging tobacco farmers to bypass the auction system altogether. These non-auction direct purchases took place at barn doors, city street corners and country crossroads. In 1889, five tobacco manufacturers led by James B. Duke received exclusive rights to use a Bonsack cigarette maker and formed the American Tobacco Company (ATC). During the next decade, the ATC either bought out or drove out over 250 major competitors, and by 1900 they controlled the majority of tobacco products sold in the United States.¹⁰

At the dawning of the twentieth century, dark clouds hung over the U.S. tobacco industry. Producers had experienced low tobacco prices for two decades, the American Tobacco Company had monopolized the market, and taxes had increased to twelve cents per pound, which was sufficient to drive out whatever profit remained in producing tobacco. Farmer disenchantment, which intensified during two decades of falling prices, ratcheted up to a new level, particularly in an area of West Kentucky and West Tennessee (known as the Black Patch because its soils were ideal for producing snuff and chewing tobacco.) To combat the American Tobacco Company, which they called the Duke Trust, tobacco farmers under the leadership of Dr. David Amoss, Felix Ewing, and Guy Dunning organized the Clarksville Planter's Protective Association (PPA) in 1904 in Guthrie, Kentucky.¹¹

The immediate goal of the PPA was to include a minimum of 70 percent (100 percent would have been ideal) of the growers in the association, which would create a condition of bilateral monopoly with the Duke Trust. Widespread efforts were made to enlist all producers and to garner the support of merchants, politicians and the general public for the association. When efforts to enroll the desired percentage of producers did not materialize and attempts to break the stranglehold of the Duke Trust proved unsuccessful, the PPA members took another approach. They organized from among their ranks a militia to further their established mission. Organized bands of the militia, or Night Riders as they became known, donned robes and masks as they visited growers who were not members of the association and pressured them to join. These visits often included

intimidation, threats, destruction of plant beds or other property, and sometimes old-fashioned horse whippings. Initially, the Night Riders focused on getting nonmembers (Hillbillies) to join the association but later concluded they would be more effective if they applied the Specificity Rule and took direct aim at the Duke Trust by destroying its property and assaulting its employees, usually tobacco buyers.¹² During the period 1905-1915, the Night Riders were responsible for destroying or burning, by conservative estimates, at least thirty-one tobacco factories or warehouses and eighty-three barns. Moreover, they destroyed a number of private homes and caused an undetermined number of assaults and deaths.¹³

Knowledge of the plight and discontent of tobacco farmers and the activities of the Night Riders reached the highest levels of government. President Teddy Roosevelt, who had genuine concern for the tobacco farmer and no love lost for the Dukes, aimed the trust-busting guns of the Sherman Act at the American Tobacco Company. The outrages of the Night Riders and the Black Patch Wars—the most dreadful, destructive, and socially divisive conflicts since the Civil War—would cease in the spring of 1911 with two important events. On March 17, 1911, a jury in the Christian County (Kentucky) Circuit Court found Dr. David Amoss not guilty of organizing or directing the Night Riders or of damages and injuries inflicted by that group. In May 1911, the United States Supreme Court put the Duke Trust to rest by upholding the lower court decisions in directing that the giant American Tobacco Company be dismantled. The breakup of the Duke Trust did not destroy the Dukes' personal fortunes and they continued to share a portion of their wealth in philanthropic endeavors. One benefactor was Trinity College in Durham, North Carolina, which on receipt of \$6 million in 1924 became Duke University. When the new Duke University Medical School was dedicated on July 19, 1930, one of the medical faculty present for the ceremony, chosen from among the best and brightest in the nation, was Dr. Harold L. Amoss, the son of a Night Rider.¹⁴ Duke University prospered, but the good fortunes of tobacco farmers, which had begun before the end of the Black Patch Wars because of increased world demand and slowing of the increase in the domestic output of tobacco farmers was not to endure. Fueled by increased world demand amid lower levels of increase in domestic output, farmers prospered even before the end of the Black Patch Wars, but by the onset of the Great Depression in the late 1920s, producers, processors, peddlers and politicians were weary of overproduction and low prices, and were looking for a new direction in tobacco policy.

The Tobacco Program

The Tobacco Program established by the Agriculture Adjustment Act of 1938, which proved to be a model federal program that required only minor adjustments, gave producers a safety net under auction prices and provided manufacturers with a stable crop of raw material for several decades. The AAA of 1938 designated parity as the formalized method of arriving at a "fair" price. Support prices were then set at some percentage of the computed parity price. The support price, which represented the minimum price farmers would receive for a unit of their product, was underpinned by the Commodity Credit Corporation (CCC), which had been set up in 1933 to take over the activities of the

Federal Farm Board. The CCC employed two broad programs to support farm prices: one focused on direct market purchases and the other on non-recourse loans. Through direct market purchases, the government bought directly from processors and handlers at the support price and then sought to dispose of the commodities through other “non-competing” outlets.¹⁵ Through non-recourse loans, it issued what amounted to government purchase contracts that enabled farmers to retain title to their commodity while turning it over to the government with the option to repurchase within a given time period by repaying the loan. Given the producer’s option to repurchase the commodity, if the market rate exceeded the loan rate, the loan rate effectively became the price support for the commodity.¹⁶

To be eligible to participate in the Tobacco Program and receive a marketing card, farmers had to accept marketing quotas that initially were tied to acreage allotments, which in turn determined the maximum acreage of the commodity they could produce. Acreage allotments for each producer were based on historical production of the farm as demonstrated by the producer and verified by the County Agricultural Stabilization and Conservation Committee designated by the United States Department of Agriculture (USDA) to oversee the program. Producers were required to report and indicate where on their farms their tobacco fields or patches were located, and their fields were later measured by an employee of USDA to ensure the farms did not exceed their designated allotments. In the event that farmers did over plant allotments, they were required, under USDA supervision, to destroy the excess acreage. In most cases this was performed in a cordial manner, but in some cases the process elicited grumbling references to socialism and communism.

Farmers also had the obligation to produce the quality of tobacco specified by the various grades established by USDA and used at marketing to qualify for different levels of price supports. After the tobacco leaf was delivered to the warehouse, but before it was sold to the highest bidder at the chant of the auctioneer, the tobacco was given a grade and corresponding support price. Any tobacco bought by the tobacco company had to exceed the support price by at least one cent per pound. Leaf not bought by a tobacco buyer was purchased by the government and went into the “pool” from which the grower received the support price. In extreme cases where the leaf was badly damaged, wet, or improperly handled, it could be rejected or not assigned any grade. In all cases, farmers had the option of letting the leaf go to the pool or withdrawing it without any selling charges assessed, and offering it for resale to the same or a different warehouse at a later date.

Although the Tobacco Program established by the AAA of 1938 brought stability to the production and marketing of tobacco, the U.S. involvement and demands of World War II quickly solved the problems of overproduction and low prices that had plagued the farm sector during the 1930s. Prices of most farm commodities began to rise in 1941 and attention shifted to price ceilings rather than price supports. Notwithstanding the economic impact of World War II, the shortcomings of parity prices in providing stability to the farm sector became apparent. Although worshipped by farmers, farm organizations and politicians in pursuit of the farm vote, the concept of parity was somewhat subjective. Parity was based on the assumption that commodity prices and input prices were properly aligned in the base period 1910-1914. Also, parity did not account for the increased

mechanization and technological changes taking place in agriculture in the early part of the twentieth century and increases in productivity resulting from these changes. Finally, parity did not take into account the different input mix for different commodities. For example, row crop production became capital intensive during the 1940s, whereas tobacco production remains very labor intensive today.¹⁷ The shortcomings of parity led to changes in farm policy during the late 1940s. Tobacco remained under the AAA of 1938, but new legislation, including the Soil Bank Program, would become the means of bringing supply in balance with demand for wheat, corn and other feed grains during the 1950s.

From 1950 to 1980, the tobacco program underwent relatively few modifications. In 1955, a 25 percent cut in the quota was approved by grower referendum in response to sizable surpluses. Large crops of burley, a thin-bodied, air-cured tobacco grown mostly in Kentucky, resulted in allotment cuts of 10 percent in 1964, 10 percent in 1965, and 15 percent in 1966. Even with these cuts in allotments, excessive supplies of American grown tobacco continued to mount. The excess supply was primarily due to increased production per acre, manufacturers' use of less tobacco per cigarette and to a lesser extent, elevated health concerns brought about by the 1964 Surgeon General's report about the health risks faced by tobacco users, and by increased taxation of tobacco products. On this last point, it should be noted that given the consumers' relatively inelastic demand for tobacco, higher taxes, like most sin taxes, were somewhat ineffective in dramatically reducing consumption, but did boost state and federal tax revenues. In 1971, after defeats in 1966 and 1967, a grower referendum to shift the Burley Tobacco Program from acreage to a poundage control passed in Congress. This policy change, which retained price supports while instituting the lease and transfer of quotas, provided a better production control mechanism to manage supply.¹⁸

Increased Problems Within the Tobacco Program

Since the early 1980s, political and economic pressures have prompted several changes in the Tobacco Program. As political pressure to modify or end the Tobacco Program gained momentum, several members of Congress and opponents of the Tobacco Program questioned how the federal government could support tobacco production while it simultaneously supported efforts to reduce tobacco consumption. The No-Net-Cost Tobacco Program Act, signed into law in 1982, mandated that the Tobacco Program operate at no net cost to the federal government or taxpayers. Cost to taxpayers arose when tobacco put under loan (tobacco taken by the Co-ops) was later sold at a price lower than the loan principal plus interest. These costs were to be paid by an assessment on growers and buyers at the wholesale level. Program opponents still argued that the existence of USDA administrative costs and crop insurance subsidies prevented the program from being a true no-net-cost program. More recent legislation prohibited any Federal expenditure on tobacco export promotion or any research related to tobacco production, processing, or marketing.¹⁹

84 Increased and expanded international competition, and the build-up of excessive pool stocks brought about the 1985 Tobacco Improvement Act which lowered price supports

and attempted to make annual changes in price support levels and quotas more responsive to changing world market conditions. The program was also modified several times in the 1980s and 1990s to allow for a more efficient transfer of marketing quotas, primarily within county boundaries. Also, as set forth in the Omnibus Budget Reconciliation Acts of 1991 and 1993, tobacco growers and manufacturers were assessed 1 percent of the support price on every pound of leaf tobacco, to be applied toward Federal budget deficit reduction. In response to escalating leaf imports, legislation was passed in 1993 to impose penalties on manufacturers who utilized more than 25 percent foreign tobacco in their blends. However, a panel of the General Agreement on Tariffs and Trade, determined that this legislation violated international trade laws, which resulted in the assessment being changed to a tariff rate quota that did little to limit imports.²⁰

Political pressure also resulted from the movement toward less regulation and freer markets for all of U.S. agriculture. The Agricultural Improvement and Reform Act (1966) terminated supply control and price stabilizing programs for most major crops, leaving only the tobacco, peanut, and sugar programs intact. A free market would allow the geographic movement of tobacco production. Quotas or production rights were originally based on historical production patterns established prior to the program in several southeastern states, primarily North Carolina, Kentucky, Tennessee, Virginia, South Carolina, Georgia, and Florida. The Tobacco Program prohibited the lease or sale of tobacco quotas across county lines (except in Tennessee) and between states. Before the Tobacco Program was initiated, anyone could grow tobacco. Given the geographic diversity of climates, soils, proximity to markets, availability of labor and managerial skills, it could be assumed that tobacco production was occurring in the most geographically efficient locations. However, as technologies, yields, and managerial skills changed over time to favor one production region over another, the Tobacco Program prevented the movement of production that would have maintained equilibrium of marginal costs among production regions. These differences in marginal costs were reflected in differences in quota lease or rental values among counties, which during the 1990s varied from a low of zero in some “high production-cost counties” to a high of fifty cents per pound or greater in some low production-cost counties.

As U.S. producers observed a continuing loss of market share to foreign competition during the 1990s, some tobacco producers in low production-cost counties began to question the benefits of the current quota system. Radical debate to completely abandon supply controls, as had become typical with agriculture generally, lacked broad support of producers in low production-cost counties. Producers in low-cost of production counties favored a policy change to allow the sale and transfer of quotas across county lines. Of course, producers in the high production-cost areas opposed such action, as did non-producing quota owners in low production-cost counties (who were receiving relatively high quota rental prices). With the exception of Tennessee, which was facing a permanent loss of some of their quota due to low utilization, or production, of quota in several high production-cost counties—efforts during the 1990s to allow for a more efficient production of tobacco failed and tobacco remained under a supply control system that prohibited transfer of production rights across county and state boundaries.²¹

Buyout Proposals

Numerous lawsuits from both within and outside the tobacco industry brought pressure on the Tobacco Program during the 1990s. Lawsuits seeking reimbursement for Medicaid or other actual or perceived costs associated with the consumption of tobacco products were filed against tobacco manufacturers by forty-six states—the exceptions being Florida, Minnesota, Mississippi, and Texas, that filed separate suits. Tobacco issues consumed an unprecedented three and one-half weeks of U.S. Senate debate and prompted visits by President Clinton and Secretary of Agriculture Glickman to tobacco-producing states. The tobacco companies and the attorney generals of the forty-six states were successful in developing an agreement to settle the existing state Medicaid lawsuits in exchange for the tobacco industry's agreement to change some of their marketing practices and to make payments to the states in excess of \$200 billion over a period of twenty-five years. These payments were to compensate state governments for the expenses incurred in the treatment of tobacco-related illnesses through government-sponsored health insurance programs and Medicaid.

In Kentucky, 50 percent of the so-called Phase I tobacco settlement funds were used instead to assist tobacco farmers in diversifying into other crops. To finance this settlement, the major cigarette manufacturers implemented relatively steep price increases (actually steeper than necessary to finance the settlement) which were expected to lower the demand for their products and consequently to lower the demand for American-grown tobacco.²² In an effort to lessen the economic impact of the Master Settlement Agreement on tobacco quota owners and growers, the National Tobacco Growers Settlement Trust was established by Philip Morris, Inc., Brown and Williamson Tobacco Corporation, Lorillard Tobacco Company and R.J. Reynolds Tobacco Company to compensate tobacco quota owners and growers for potential reductions in their tobacco production and sales. These payments, commonly referred to as Phase II payments, totaled \$4.15 billion and were earmarked for payment to tobacco quota holders and producers in fourteen states over the 1998-2007 period.²³ The agreement did stipulate that there would be a dollar-for-dollar offset for any future legislation that required the tobacco companies to finance a buyout of the Tobacco Program. It should be noted that Congress could have eliminated the tobacco program and Phase II payments would have continued as long as the companies did not have to finance a buyout. In fact there were efforts to get the buyout funded by taxpayers in order to keep Phase II payments continuing after the buyout.

In addition to lawsuits by states over health related issues, an anti-trust class-action suit was filed in 2000 by U.S. tobacco growers against U.S. tobacco manufacturers and dealers. The lawsuit alleged that U.S. tobacco buyers colluded to fix auction prices and intended to dismantle the Federal Tobacco Program. While not admitting any guilt to the alleged charges, each of the major tobacco companies and dealers, with the exception of R.J. Reynolds Tobacco Company, signed on the original settlement agreement in May 2003 and RJR eventually settled as well. The total settlement was \$211.8 million, with \$200 million designated for U.S. tobacco growers and quota holders (\$100 million each), \$5 million allotted to lobby Congress for a buyout, \$3 million allocated to tobacco research

and extension programs at land grant universities, \$2 million given to monitor purchase guarantees outlined in the agreement, and \$1.8 million allocated for administrative costs associated with distribution of settlement funds. Attorney fees, determined by U.S. District Judge William R. Osteen, were added to the \$211.8 million settlement. Within the agreement, Philip Morris, Brown and Williamson, and Lorillard agreed to a minimal purchase agreement of 405 million pounds annually for the next ten years (or twelve years if a buyout occurred), subject to changes in cigarette production and the volume of U.S. tobacco produced. As for R.J. Reynolds, in April 2004, just prior to the opening of the trial, R.J. Reynolds Tobacco Company agreed to a settlement that awarded an additional \$33 million to tobacco farmers (adjusted for lawyer's fees) and a 35 million pound purchase commitment of U.S. tobacco.²⁴

In addition to political pressure from some non-tobacco advocates and tobacco companies, growing opposition to the Tobacco Program began to escalate among tobacco farmers during the latter 1990s and early years of the new century. First, while the program did provide price stability, it did not protect against quota instability. Tobacco growers, who were accustomed to large swings in prices for other agricultural commodities, revered the tobacco program because it minimized price instability. But if excess supply conditions evolved as they did several times during the 1990-2004 period, given stable prices, the only other variable to adjust to get the market back into equilibrium was to adjust the quantity (i.e., quota) level. Consequently, the program operated to stabilize prices by destabilizing quotas. This was especially problematic for large growers who had invested in achieving a productive capacity that was dependent upon being able to secure sufficient quota. Once productive capacity investments were made, large quota cuts that occurred regularly during the latter part of the 1990s and early in the next decade elevated the cost of renting in additional quota to a record high level: fifty to seventy-five cents per pound or more (which was approximately 25 percent to 40 percent of the farmer's market price) and thus reduced net returns to non-quota holding growers in the short run who wanted to maintain a certain production base to fully utilize existing land, labor, and equipment resources. In the long run, a permanent quota decline forced some producers to exit production. Moreover, restricting quota transfer across county boundaries induced additional inefficiencies as it did not allow production to move to the lowest cost areas. Also, the program had provided an economic price "umbrella", under which foreign competition had developed. As a result, the program's effectiveness diminished in its latter years as production increases and quality improvements overseas further deteriorated U.S. tobacco price competitiveness and thus market share.²⁵

Internal opposition to the Tobacco Program was also enhanced by the growing disunity of quota holders and growers. When the program originated in the 1930s, farmers who acquired production rights were the actual growers. However, over time, quota holders quit growing the crop for a variety of reasons, but through the ownership of land retained the farm's production rights. Consequently the number of quota holders escalated in relation to the number of growers, which was of political significance since the optimal policy goals for quota holders were sometimes at odds with those for growers. Also, complicating the set of pressures to maintain, change or eliminate the Federal

Tobacco Program were differing demand elasticities across types of tobacco, varying production characteristics by region and differing quota arrangements leading to opposing desires regarding program operation and continuation.²⁶

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Despite escalating problems within the tobacco industry and several initiatives to terminate the Tobacco Program, it remained intact during the twentieth century. One reason is that once government programs have been institutionalized, they are slow to recede and seldom disappear. Secondly, the Tobacco Program sustained a relatively large number of small family farms over the years and succeeded in creating a structure that further supported continuation of the program. Termination of the program would likely shift production to lower-cost production regions, affecting many rural communities dependent upon tobacco income with limited alternative economic opportunities. While this argument may not hold ground in a debate about economic efficiencies, it had persuasive power in political debate. Support for the Tobacco Program also came from some health advocates who believed that elimination of the program would lower manufacturers' input costs, leading to lower prices and greater consumption.²⁷ Finally, ownership of farmland with a tobacco quota conveyed to the owner an entitlement of economic value, in the same sense that the purchase of a radio station conveys the right to broadcast at a given frequency. While growers would have benefited from price reductions associated with termination of the program, quota holders, who leased out their quota and who outnumbered growers four to one, had the political clout to retain the program unless they were "fairly" compensated.

When the twenty-first century dawned, the political and economic stage was set for a tobacco buyout and termination of the Tobacco Program. The value of U.S. tobacco production had declined from \$2.8 billion during the 1990s to \$1.7 billion in 2002. Increasing international tobacco production, coupled with improved foreign quality had, over time, narrowed the number of premium tobacco manufacturers who were willing to pay for U.S. leaf. Furthermore, the price differential between U.S. and foreign tobaccos had generally widened in recent years, causing further erosion in the U.S. market share of world tobacco production and trade. Domestically, retail cigarette price increases—in response to the Master Settlement Agreement, excise taxes and additional wholesale price adjustments, increasing health concerns and smoking restrictions—resulted in U.S. cigarette sales dropping by more than 14 percent over the 1996-2002 period. Cigarette tax increases rose in twenty-one states in 2002, which further reduced U.S. cigarette

consumption. Furthermore, U.S. cigarette manufacturers had shifted a noticeable portion of their production overseas, causing 2002 U.S. cigarette exports to fall by more than 50 percent from the record 1996 level. Accounting for the drop in domestic cigarette sales and exports, U.S. production declined 35 percent between its 1996 peak and 2002. In addition, U.S. cigarette imports which contain little, if any, U.S. tobacco, escalated after this decline. Consequently, all of these factors prompted U.S. cigarette manufacturers to increase their share of imported leaf to protect profit margins. Collectively, these factors resulted in a dramatic decline in U.S. tobacco quotas which fell by more than 50 percent from 1998 to 2002. With less quota available, quota rental rates soared to record high levels. Given these developments, there was increasing support for U.S. tobacco policy reform to compensate quota owners for eliminating their government-created asset and to transfer production opportunities solely to active tobacco growers. The task ahead was designing a buyout program acceptable to all major participants.²⁸

While Congressman Charlie Rose floated the concept of a tobacco buyout in 1994, political debate to move a buyout forward in reality began in 1997 as part of Senator McCain's effort to legislate a National Tobacco Settlement that required the tobacco companies to pay assessments and limit marketing activities in exchange for limiting future liability for smoking-related illnesses. Ultimately, Senator McCain's legislation was defeated and the companies eventually worked out a non-legislative solution in the Master Settlement Agreement. Buyout discussions resurfaced in 2000 as part of President Clinton's Presidential Tobacco Commission—a group of tobacco farmers, health officials, and rural development representatives who proposed an increase in the federal excise tax to fund a tobacco program buyout.

Amidst rapidly declining quotas and a very pessimistic outlook, farm organizations and tobacco state congressional members intensified their efforts for a buyout in 2002. This movement was enhanced by Philip Morris' initiation of a strong lobbying effort in 2002 for a tobacco quota buyout coupled with Federal Drug Administration regulation on tobacco products. Consequently, multiple tobacco buyout bills were introduced in the U.S. Congress in 2002 and 2003.

Emerging from this proposed legislation were four issues that dominated the discussion relating to a tobacco buyout. First, the buyout structure in terms of compensation levels for quotas and grower transition payments, second, the post-buyout tobacco policy, third, funding sources for the buyout, and lastly, potential FDA regulations on tobacco products.²⁹ Several of the bills attempted to retain provisions of the Federal Tobacco Program, such as restrictions on the quantity and location of tobacco production after the buyout and some form of safety net for continuing growers against price volatility. The FDA component was believed necessary to gain the support from non-tobacco producing states. Farm leaders were confident that legislation would pass in 2003, as tobacco state members were in key legislative leadership positions and others were running for governor, like Ernie Fletcher, or even President, like John Edwards.³⁰ However, many members had numerous concerns over additional government regulation—even if it was for tobacco companies whose reputation in Washington D.C. had diminished greatly over the years. And furthermore, Philip Morris' competitors mounted a strong advertising and lobbying campaign to defeat FDA regulation (and the

buyout) as they feared marketing and other regulation limitations would further enhance Philip Morris' market share of the domestic cigarette market. Consequently, no buyout legislation was passed in 2003 and chances for its ultimate passage were fading.

Entering 2004, tobacco state congressional members decided to make a final attempt to successfully pass tobacco buyout legislation. They debated whether or not FDA regulation was the appropriate vehicle to move buyout legislation forward. Ultimately, after some very intensive floor debate, the buyout was attached to a piece of legislation identified as a "must-pass" corporate tax bill called the American Jobs Creation Act. This measure benefited U.S. exporters and was promoted in an election year as a bill that would create jobs. When President Bush signed the American Jobs Creation Act of 2004—legislation that included the Fair and Equitable Tobacco Reform Act establishing the Tobacco Transition Payment Program (better known as the tobacco quota buyout), it terminated the federal tobacco quota and support programs. The \$10.1 billion legislation provided \$9.6 billion in total compensation and transition payments to tobacco quota owners and active growers. Quota owners were eligible to enter into a payment contract if they owned a basic marketing quota or allotment for the 2004 marketing year as of the date of enactment. Eligible quota owners were to be paid seven dollars per pound for the basic quota they owned in 2002. For kinds of tobacco with acreage-based quotas or allotments, a poundage equivalent was computed by multiplying an individual's 2002 allotment by the 2001-2003 (three-year) county average yield for that kind of tobacco. Quota owner payments were to be distributed equally over ten years, 2005 through 2014.³¹

Producers were eligible to enter into a buyout payment contract if they were an active tobacco producer (meaning they shared in the risk of producing tobacco) in the 2002, 2003, or 2004 marketing year. Growers were paid on their effective 2002 marketing quota as the USDA used a complicated scheme to include both effective quota and marketing to determine grower pounds eligible for the buyout. Eligible growers were paid three dollars per pound for their 2002 effective quota. Active growers participating in all three marketing years—2002, 2003, and 2004—received the full grower payment of three dollars per pound times the 2002 effective quota. Active growers participating in two of the three marketing years or one of the three marketing years received two-thirds or one-third respectively of the full grower payments. For kinds of tobacco with acreage-based quotas or allotments, a poundage equivalent was computed by multiplying an individual's 2002 effective allotment by the 2001-2003 average farm yield. For growers involved in a sharecropper arrangement, grower payments were divided according to the sharecropper agreement. Grower payments were to be distributed for ten years, beginning in 2005.³² The buyout was to be funded by quarterly assessments on tobacco manufacturers and importers where manufacturer and importer assessments are based on their share of gross domestic volume or market share. Provisions allowed quota owner and grower contract payments to be made directly to financial institutions instead of the individual. This allowed banks and other financial institutions the option to offer discounted lump sum or other accelerated payments in exchange for the full ten-year payout. There were also provisions for transferring contract payments to a spouse or estate in the event of the death of a tobacco quota holder or grower.

90 The buyout includes provisions for the orderly disposition of pool stocks and no net

cost funds and allocated \$0.5 billion to cover any losses USDA may incur related to disposal of pool stocks. Also, beginning with the 2005 crops, there would be no provisions for quantity restrictions, geographic growing restrictions or safety nets (e.g., price supports, price or revenue insurance, annual production permits or loans). Because the buyout was to be funded by manufacturer and importer assessments, future Phase II payments were terminated. Finally, the buyout was not linked to any provisions granting FDA the authority to regulate manufactured tobacco products.

The tobacco buyout has been labeled by some as a “political miracle.” Many political experts have been amazed at how a relatively small number of farmers, primarily from seven states, could garner enough political support for a buyout of a controversial federal program totaling more than \$10 billion. The passage of the tobacco quota buyout was arguably the most significant and far-reaching piece of agricultural policy legislation for farmers and rural communities in the main tobacco states since the development of the federal tobacco program in the 1930s. As with any major and controversial piece of legislation, not everyone was completely satisfied with the outcome. Some farmers were disappointed that the buyout dollars were reduced from earlier proposals, by the loss of future Phase II payments, and by the termination of a popular and historically successful federal program designed to balance supply with anticipated demand and provide an effective safety net. But the alternative was to watch quotas and the value of this asset slowly dwindle away, trying to “fix” a program that may not have been “fixable” and that would have benefited both quota owners and growers, and perhaps even see the program terminated with no compensation.

The outlook for the post-buyout era remains very uncertain. A large percentage of the pre-buyout tobacco farmers will exit. The elimination of price supports and production restrictions will cause U.S. leaf prices to gravitate to the level of the world market with some premium for its superior quality characteristics. It is also anticipated that production will shift to the areas and producers that are most efficient. The limiting factors on production may not be health issues but the availability of labor for the large producers, and the ability to access markets for small producers. After some adjustment period, U.S. tobacco production and demand is expected to rebound as the market reacts to increased price competitiveness and an overall lower cost structure without the presence of quota rent. But it remains unclear who will survive without a safety net and which rural economies will be able to capitalize on a potentially growing market. Without any federal guidelines, the ultimate fate of U.S. tobacco growers in the post-buyout era will be determined by how effectively they compete in a free-market comprised of a few large multinational tobacco buyers who possess considerable market power. In a sense U.S. tobacco producers are in “uncharted waters,” but on closer observation some of the surroundings may look familiar to those seen some sixty-six years earlier. As Shakespeare reminded us, “All the world’s a stage, and all the men and women merely players.”³³

NOTES

1. *Federal Register*, Part II, Department of Agriculture, Tobacco Transition Payment Programs: Final Rule, April 4, 2005.
2. George Brown Tindall, *The Emergence of the New South 1913-1945*, Volume X, (Louisiana State University Press, 1967), 393-403. The AAA of 1933 contained most major devices that had been advanced for farm relief. The South received the most benefits in terms of prices and income, particularly the regions producing tobacco and cotton.
3. Rainer Schickele, *Agricultural Policy: farm programs and national welfare*, (New York: McGraw-Hill, 1954), 188-192.
4. Agricultural Adjustment Act, Public Law 10, 73d Cong., 1st Session. Title I, Sec. 2 (1933). For tobacco, the base period of price parity was from August, 1919 to July, 1929.
5. Ronald D. Knutson, J.B. Piner and William T. Boehm, *Agricultural and Food Policy 2*, (Englewood Cliff, New Jersey: Prentice Hall, 1990), 241.
6. Don Paarlberg, *Farm and Food Policy: Issues of the 1980s* (Lincoln: University of Nebraska Press, 1980), 25.
7. Richard L. Kohls, *Marketing of Agricultural Products* (New York: The Macmillian Company, 1955), 129-130.
8. Milton M. Snodgrass and Luther T. Wallace, *Agriculture, Economics and Growth* (New York: Appleton-Century Crafts, 1964), 372.
9. Randall Elisha Green, *The Leaf Sellers, A History of U.S. Tobacco Warehouses: 1619 to the Present* (Lexington: the Burley Auction Warehouse Association, Inc., 1996), 13-16.
10. Green, *The Leaf Sellers*, 25-30.
11. Bill Cunningham, *On Bended Knees: The true story of the Night Rider tobacco war in Kentucky and Tennessee* (McClanahan Publishing House, Inc., 1983), 37-43. This is one of the greatest works done on the Night Rider Era in Kentucky and Tennessee.
12. Bill Cunningham, *On Bended Knees*, 44-142.
13. Randall Green, *The Leaf Sellers*, 32.
14. Cunningham, *On Bended Knees*, 71 and 181-213.
15. Kohls, *Marketing of Agricultural Products*, 130-132.
16. Schickele, *Agricultural Policy*, 190-192.
17. Knutson, *Agricultural and Food Policy*, 1990, 241-242.
18. A. Blake Brown, William M. Snell and Kelly H. Tiller, "The Changing Political Environment for Tobacco—Implications for Southern Tobacco Farmers, Rural Economics, Taxpayers and Consumers." Paper presented at the Southern Agricultural Economics Association Annual Meeting in Memphis, Tennessee, February 2, 1999, 6-7.
19. A. Blake Brown, William M. Snell and Kelly H. Tiller, "The Changing Political Environment for Tobacco," 1999, 6-7.
20. Brown et al., "The Changing Political Environment for Tobacco," 8.
21. Brown, et al., "The Changing Political Environment for Tobacco," 10-14.
22. Brown, et al., "The Changing Political Environment for Tobacco," 1-2, 7-10.
23. Governor's Office for Agricultural Policy, "National Tobacco Growers Settlement Trust History—Phase II Payments," Frankfort, Kentucky, February 26, 2006.

24. William M. Snell, "Tobacco Grower Settlement Update," University of Kentucky Cooperative Extension Service, University of Kentucky College of Agriculture, Lexington, Kentucky, June 2003, 12.
25. Brown, et al. "The Changing Political Environment for Tobacco," 9-10.
26. Jack Temple Kirby, "The Production of Flue-cured Becomes More Mechanized Than the Production of Burley and Influenced Grower's Views With Respect to the Size of Quotas," *Rural World's Lost, The American South 1920-1960* (Louisiana State University Press, 1987): 346-348.
27. Brown, et al. "The Changing Political Environment for Tobacco," 8-9.
28. A. Blake Brown, (North Carolina State University) and William M. Snell (University of Kentucky) "Policy Issues Surrounding Tobacco Quota Buyout Legislation," North Carolina State University, 1.
29. Brown and Snell, "Policy Issues Surrounding Tobacco Quota Buyout Legislation," June, 2003, 2.
30. Along with Congressman Ernie Fletcher (R-KY) and Senator John Edwards (D-NC), other members of the U.S. Congress holding key leadership positions included Senator Mitch McConnell (R-KY), Senate Minority Whip; Congressman Bob Goodlatte (R-VA), Chair of the House Ag Committee; and Congressman William Jenkins (R-TN), Chair of the House Specialty Crops Subcommittee which had jurisdiction over the tobacco program.
31. Kelly Tiller, William M. Snell and Blake Brown, "Tobacco Quota Buyout Provisions," University of Kentucky Cooperative Extension Service, University of Kentucky College of Agriculture, Lexington Kentucky, October 12, 2004, 1.
32. Tiller, et al., "Tobacco Quota Buyout Provisions," 1-2.
33. William Shakespeare, *As You Like It*, Act II, Scene vi, lines 142-147, Jaques is speaking.

