# TOBACCO OUTLOOK FOR 1999

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## National Tobacco Issues

The tobacco agreement process still drives this industry. In June, 1997 the first agreement was signed between the tobacco companies and Attorney Generals. This became one of the major news stories of 1997 and 1998. To be effective, the agreement had to be ratified by Congress. However, Congress upped the cost from around $360 billion by another $200 billion (depending on the legislation); proposed numerous bills, debated the issue for approximately three and one-half weeks without coming to a consensus, and the President became highly involved. This intensive political activity was an indication of the importance of this issue.

In the latter part of 1998, the companies and states Attorney Generals signed a multi-state agreement which allotted monies to each state. South Carolina was a participant and is now in the process of determining where these funds will be spent. This pact supposedly settled with the states but there are still many individual, municipal, county, other, and even international suits pending. Supposedly, to accomplish the intent of the original 1997 agreement, Congress still must act. It is currently unknown if there will be national legislation during this next year(s).

As of this time, tobacco producers, communities and supporting industries have not been officially included. Efforts were made to include producers and communities in several bills of the now defunct national legislation. As part of the multi-state agreement, meetings and proposals continue but as of this date, nothing has been finalized. There has been some press regarding a producer trust fund as an extension of the multi-state agreement (money above the agreement) with a value of $5.15 billion if all companies participate or $3.8 billion if there is a reported partial company buy-in. If there is such a fund, the individual state shares, although published but varying by source, has not been determined. Depending on the producer formula (whether all types of tobacco grown, program types of tobacco, tobacco types with reductions, etc.), this state would participate based on our prorated share of production. With so much uncertainty and complexity, producers, producer groups, etc. are having a difficult time in understanding the implications or best policy action.

What impact will all this have on the tobacco producers? The original agreement contained a paragraph of intent regarding the tobacco grower community. In essence, it said that since the growers and communities may be adversely affected by the potential reduction of tobacco consumption, then they (it is assumed “they” are companies, government, others receiving funds, etc.) would work cooperatively to address these issues. Back in July, 1997 we wrote:

> “The tobacco industry underwent non-reversible changes when they signed the landmark Tobacco Agreement... this is the case, regardless of whether there is a tobacco settlement or not.”

From a grower's standpoint, this was evident in the reduced 1999 flue-cured quota levels. Quota issues will be discussed later. The outlook for producers/quota holders is dismal for continuing future production levels necessary to maintain economic survival. This problem is further enhanced by the continuous "off and on" indications of some buy-down or buy-out relief, and the present economic situation.

## The Tobacco Program

The federal tobacco program is one of the few government programs left in U.S. agriculture. It is over 60 years old and still serves most types of U.S. tobacco. This state grows flue-cured type tobacco which is part of the tobacco program. The purpose of this program has been to restrict supply in order to improve and stabilize farmers income. In accomplishing this, production has been restricted through allotments while price reductions have been limited by a minimum or support price). Price has remained fairly constant. However, the cost of price rigidity is quantity (or quota) instability. This is why quota has varied so widely. This leads to significant management/risk problems for producers who have invested heavily in tobacco production systems of a specific size. This is partially the explanation for the high levels of quota rents during this past and current year.

For the present, the current tobacco program remains operational but highly debated. There have been several recent attempts to either eliminate or change the program. From one standpoint, the free market forces have submitted legislation to dismantle the program. In addition, several foes question the government policy of trying to educate the public against using tobacco while supporting the growing of the crop. Since 1982, this program has been operated on a "no-net-cost" basis with debate about if or should the administrative costs be also paid by the farmers. On the other hand, some health groups have advocated keeping the program since the elimination of the program would likely reduce the cost of leaf tobacco and thus, cigarettes.

To the producers, the concern is the longevity of the tobacco program. With the current uncertainty, producers wonder if the entire tobacco program will be dismantled or altered significantly or remain as is? Is the elimination of the entire program possible over the next few (or, say 25) years because of either direct or indirect actions from agreement(s) activity?

## Outlook For 1999

The 1999 flue-cured basic quota was not good news for producers as it was 17.5 percent below last year. The basic quota level was 666.2 million pounds (m.p.) as compared to 807.4 m.p. in 1998. This was a massive decrease of more than 30 percent over the past two years.

The first major component of the quota formula was the company purchase intentions of 28 percent below 1998. These intentions were 327 m.p. and not surprising because of recent action such as the national agreement between companies and states Attorneys General, cigarette price increases, and a multitude of other industry activity/potential future activity.

Some other parts of the quota formula were: exports at 355.2 m.p. as compared to 371.9 m.p. in 1998; and, reserve supply level (15% of previous year) at 121.1 m.p. vs. 146.1 m.p. in 1998.

Another important variable was stabilization stocks. As the year ended, stabilization held over 250 m.p. of surplus leaf. Based on these stocks, the 1999 quota would have been an economic disaster for producers and would have had serious long-term impacts on export offerings and domestic supply. In an eleventh hour agreement between stabilization and the companies, an additional 103 m.p. were sold at discounted prices. This was accomplished despite a considerable amount of industry and political activity during this short but important period. The final part of the quota formula calculation was the Secretary's discretionary adjustment. The Secretary of Agriculture had the option of adjusting the formula between -3 to +3 percent and for the second consecutive year, the adjustment was +3 percent.

Tobacco is no longer the stable component of agriculture. This was the smallest flue-cured quota in the history of the U.S. tobacco program. In 1987, while program changes were taking place, quota dipped to 707 m.p. Although present outlook is bleak, there may be some long-term considerations. Assuming the tobacco program remains in place, and most of the major factors continue at reasonable levels, the year 2000 flue-cured quota level could move back up to at least the 700-750 m.p. range. Although quota levels will probably not be near the highs of 1996-97, they could fluctuate around 85 to 90 percent of these levels for several years.

South Carolina tobacco cash receipts (which is the grower income) will be significantly down for this next year. Although the absolute figures have not been announced, state tobacco acres should drop from about 47 thousand acres to slightly over 42 thousand acres. In 1998, South Carolina growers marketed 100.1 percent of their effective quota. Although some areas of the state were hard-hit by weather, fall leasing allowed those areas with excess production to market most of their surplus pounds. South Carolina should have a quota of about 82 m.p. for next year. This will likely result in over a $30 million loss in farm-level income.

Not only will this large reduction significantly impact growers and quota owners, but will also affect lenders, warehouses, input suppliers, and local businesses. This will also likely slow capital purchases such as balers and may alter the adoption of this new technology. Growers are being encouraged to give special attention to all production practices, inputs and management decisions.

## The Future

For the future, it is uncertain what is ahead for U.S. tobacco production. Given all the debate, agreements, turmoil, etc. in the industry, it is currently unknown how the companies, exporters, and dealers will react. Much of this is dependent upon such factors as the tobacco settlement(s), litigations, price increases, exports/imports, potential taxes, legal activity, and possible changes in regulations and restrictions. Despite all the chaos, problems, uncertainties, barriers, and conflicts, tobacco production has survived a long time -- the future will likely be different than the past.