FINAL REPORT OF THE KENTUCKY TOBACCO TASK FORCE

Research Report No. 221

Legislative Research Commission
Frankfort, Kentucky

KENTUCKY LEGISLATIVE RESEARCH COMMISSION

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FINAL REPORT OF THE KENTUCKY TOBACCO TASK FORCE

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FOREWORD

Recognizing tobacco's central role in Kentucky's economy and history and the threats which faced the tobacco program, the Kentucky House of Representatives passed HR 61 during the 1984 General Assembly.

House Resolution 61 directs the Legislative Research Commission to study the problems facing the tobacco program and the possible impact of loss of the program on Kentucky. Those problems include impact of no-net-cost assessment, imports, and other factors affecting foreign and domestic production.

The Tobacco Task Force was formed as a result of HR 61.

This report details the major efforts and the activities of the Tobacco Task Force, which has spent many hours in efforts to help ensure the continuation of a viable tobacco program. This report also provides background to assist the reader in understanding the tobacco program, its importance to Kentucky, and the elements which have threatened the program.

Staff services for the Tobacco Task Force were provided by Brooks H. Talley, Andrew Cammack, and Daniel J. Risch, and secretarial services were provided by Stephanie Kirtley and Phoebe Lovan.

The Report was written by Andrew Cammack and edited by Charles Bush.

The task force has publicly acknowledged, and desires to repeat here, its appreciation to the great number of people who assisted in the task force's work. Among the many were representatives of the United States Department of Agriculture, the Burley Cooperative, the Farm Bureau and other farm organizations, public, farm and industry representatives and Kentucky's Congressional delegation and staff.

TABLE OF CONTENTS

LIST OF FIGURES

SUMMARY AND CONCLUSIONS

The Kentucky legislative Tobacco Task Force was set up by the Kentucky Legislative Research Commission following passage of House Resolution 61 in the 1984 General Assembly. At that time, the tobacco price support program was threatened with collapse, because of the buildup of tobacco in the price support pool, the rapid increase of imports, and the no-net-cost assessment farmers must pay to service the price support program debt. The Task Force was set up to address these and other problems of the tobacco program and has worked to assist in any way it could to help save and maintain a viable tobacco program for the state.

The task force concluded that its billion dollar tobacco industry is essential to Kentucky's economy. Eliminating or seriously reducing the tobacco program would have a devastating effect on Kentucky and its tobacco farmers. Without the program, many, many small farms and businesses in Kentucky would no longer be viable. Many farmers would face real difficulty in finding new employment. Land prices would fall, loans would default, local and state revenues would suffer and the farm economy and social fabric of rural areas would be grossly changed and impoverished.

The task force found that the following problems plagued the tobacco program and tobacco farmers. The no-net-cost assessment that farmers must pay to defray the cost of the tobacco price support program was set to rise to an unbearable 30 cents per pound in 1985. Excess burley stocks held in the price support pool had risen to well over 500 million pounds—many times over needed reserve levels. The market for U.S. burley was weak. Imports had soared from less than 1 percent of use in 1970 to 29 percent in 1984 and exports had dropped from 60 percent of the world market in the 1950s to 25 percent in 1982. In a failed effort to address oversupply of burley in the pool and to maintain price levels, burley quotas were cut nearly 25 percent from 1983 through 1985. The price support program was threatened with collapse as the no-net-cost assessment was becoming unbearable and farmers' quotas and share of the world market were declining to unacceptable levels.

These changes were brought about by many factors. Tobacco consumption was declining in the U.S. and other countries. World demand was stagnant. Taxes on cigarettes had been increased. Price supports held up U.S. prices, while foreign production of cheap burley increased competition in the world market. This situation was exacerbated by the strength of the dollar abroad. New technology required less tobacco per cigarette and lower quality foreign burley was increasingly being used as a filler in U.S. cigarettes. Foreign subsidies to tobacco growers and exporters and even encouragement to foreign growers by American companies added to domestic burley problems.

Through twenty-four meetings, including seven public hearings, the Tobacco Task Force evaluated the problems facing the tobacco program and the tobacco farmer and sought every opportunity to assist in improving the situation. Two of the most immediate concerns were imports and the no-net-cost assessment.

In early 1985 task force members testified regarding imports before the International Trade Commission. Their testimony stated that the President should take immediate legal action under Section 22 of the "Agricultural Adjustment Act" to reduce tobacco imports because they render ineffective the tobacco price support program. The task force further recommended to the President that:

The United States should not allow tobacco imports from those countries which do not allow American tobacco into their countries, which subsidize the production or manufacturing of tobacco, which use pesticides and herbicides not allowed on American-produced tobacco, or which do not allow a fair and just market for American products, the task force recommended that imported tobacco be charged a single rate of duty for each pound, regardless of the classification. Clearly, the task force viewed imports as a problem which must be resolved.

In April, the task force held the first Tobacco Conference of the States. This conference brought state legislators together from nine tobacco states in an unprecedented show of unity and support for the tobacco program. The conference concluded with the adoption of a resolution by the states which created a permanent Tobacco States Conference, to make a united effort to work out details necessary to save the tobacco program. Kentucky supported the following Plan of Unity and Action:

> That manufacturers along with producer representatives be encouraged to enact a plan to minimize the growers' no-net-cost, reduce tobacco imports, and increase the world-wide market share. (These were among the goals examined but not necessarily fully achieved in the development of the "Reynolds Plan" and later, S.1418, "The Tobacco Program Improvement Act of 1985.")
>
> If no agreeable plan is forthcoming from Congress, the task force hereby supports a federal tax on cigarette manufacturers to pay for the cost of the no-net-cost program in support of tobacco farmers (This approach was taken by Representative Charlie Rose in HR 2600, to be discussed later).
>
> If a federal excise tax as described above is not forthcoming, then the task force supports a state level manufacturers' tax on the cigarette industry to support the no-net-cost program for tobacco farmers.

The task force continues to support these priorities.

Intense negotiations during 1984-1985 among farmers, farm organizations, burley coops, and tobacco companies and tobacco state Congressmen produced the "Reynolds Plan" and later S.1418, designed to address the tobacco program's problems. The bill would lower the price support for burley by about 30 cents to $1.45 per pound. The no-net-cost assessment would be shared 50/50 between growers and tobacco companies, and the tobacco companies would buy-out surplus burley in the pool over five years.

The forging of S.1418 required many compromises. The task force responded positively to the proposed legislation, but voiced the following concerns to the Congressional Delegation. The task force focused on the farmer's plight and maintained that if the farmer had to take a 30 cents per pound cut in the price support, he should not have to pay 50 percent of the no-net-cost assessment; imports should be dealt with in the legislation; discounting the 1983 crop 90 percent is excessive and farmers should have first right of refusal to purchase this pool tobacco and if they choose, destroy it and add the poundage to their quota for future crop years; use of manufacturer's estimates of future purchases to provide a basis for quotas could cause problems; and the formula used to calculate the support price could suppress the price in future years.

A stop-gap measure which would not deal with the long-range problems of the tobacco program was passed by Congress at the last minute before the 1985-86 burley sales began. The measure would lower the support price 30 cents and the no-net-cost assessment from 30 cents to 4 cents. Under this scenario, farmers would receive less money but less tobacco was expected to go to the pool. This would make an eventual buy-out of pool stocks easier for tobacco companies if S.1418 or some similar measure passes Congress. Since the 4-cent no-net-cost payment wouldn't pay for past debts on loan stocks, passage of S.1418 or some similar comprehensive measure remains absolutely essential to the salvaging of the tobacco program; without passage of S.1418, the no-net-cost assessment could again become unbearable in 1986.

As the year ended, a measure to address the first goal outlined by the task force at the Tobacco Conference of States—that manufacturers and producer representatives enact a plan to minimize the growers' no-net-cost, reduce tobacco imports, and increase the world-wide market share—remained stalled. Congress adjourned without passing out the budget reconciliation measure to which S.1418 was attached. It is uncertain whether S.1418 could be passed before burley farmers vote in February on whether to continue the tobacco program. Thus as 1985 ended, the tobacco program faced real uncertainty.

As 1985 came to a close, burley prices were around [illegible]. Considering no-net-cost, this was 23 cents per pound less than in [illegible]. If [illegible] of the tobacco was going into the pool, this was considered acceptable for a buy-out of stocks under S.1418.

Throughout this turbulent period for the tobacco program, the Tobacco Task Force has had the vital role of gathering and disseminating information, uniting tobacco interests, and working toward resolution of the price support program's problems. Because problems still face the tobacco program and because the need for leadership and unity remains critical, the Tobacco Task Force should be continued. A resolution to reauthorize the task force has been prefiled with the 1986 General Assembly and is included in Appendix [illegible].

CHAPTER I

BACKGROUND

History and Functioning of the Tobacco Price Support System

In the early 1900s, prices and supplies of tobacco fluctuated widely and farmers consequently suffered; at times they were unable to sell their crops. The federal government began to operate programs to stabilize tobacco prices in the early 1930s. As a result, risks to growers lessened considerably and a successful price support program evolved. The following information on the price support program and much of the information for this chapter—except for the "Economic Impact" subsection—were taken primarily from USDA reports, particularly "Tobacco, Background for 1985 Farm Legislation." Portions of pages 9-11 were taken from Congressional Research Report 84-80ENR.

The price support program, operated by the U.S. Department of Agriculture, under the authority of the Agricultural Adjustment Act of 1938, regulates production and supports tobacco prices. Supply control through marketing quotas and price support through loans, are the basic elements of the program. Marketing quotas are mandatory on growers, but only after the program has been approved in a referendum vote by a two-thirds majority of tobacco farmers.

The precise level of the marketing quota for tobacco is determined by the USDA prior to each growing season according to a formula specified in the Agricultural Adjustment Act of 1938, as amended. The national quota is a projection of the production needed to meet domestic and export demand (at or above the price support level) and to provide for reasonable carryover stocks. This national quota controls supply and functions as a price-raising mechanism. The National quota is adjusted to reflect over-marketings and under-marketings of the previous year's quota. These revised quotas are called effective quotas and indicate the actual quantities of tobacco that may be marketed in a given year.

The marketing quota is translated into a national allotment. Each tobacco farm, based on its historical production, is given a share of the national allotment. This farm allotment then becomes the upper limit on the amount of tobacco each farm is allowed to produce and market. Burley farmers are under a poundage program that was authorized in 1971. The allotment's attachment to the land restricts the entry of new tobacco producers into the market.

If tobacco producers vote to adopt marketing quotas, then the federal government must provide price support. The national level of price support is calculated according to a formula specified by law. Each of the grades of tobacco is assigned a support price;

averaged, these prices together achieve the national support level. Until very recently, the support level was adjusted each year to reflect recent changes in farmer's production expenses.

The price support program works through loans from the Commodity Credit Corporation (CCC), with the tobacco held as collateral. The CCC loans are made to producer associations, such as the Burley Tobacco Growers Cooperative Association, Inc., that are under contract with CCC to handle all operations connected with making loan advances to tobacco farmers, and arranging for receiving, processing, storing, and eventually selling the tobacco under loan.

When tobacco is sold at auction, each lot is auctioned to the highest bidder, except that if the high bid does not exceed the support price, the tobacco is consigned to the price stabilization cooperative; it goes to the "pool." Farmers are paid by the cooperative at the loan rate for tobacco consigned to the cooperative. Over time, the cooperative sells the tobacco placed under loan at prices established jointly by them and CCC.

After the tobacco is sold by the producer cooperative, proceeds are used to reimburse CCC, with interest, for its loan advances. Prior to 1982, all excess receipts were distributed to the producers and any losses were covered by CCC. The cumulative net loss of tobacco loan principal from 1933 through fiscal year 1983 has amounted to only around $56 million. For purposes of comparison, this loss represents only .3 percent of CCC's total cumulative loss on all commodity loan inventory operations.

The tobacco program has assured a stable income to growers and generally kept supply and demand in reasonable balance, especially during the first three decades of its existence. However, beginning in the late 1960s especially after the mid-1970s, some observers believed that the rate of increase in price supports was too rapid. The price support formula was changed in 1960 to slow the rate of support increases. In 1971 the burley program went to a poundage, rather than acreage, program for better control of production. Partly because of a concern by tobacco program supporters that legislative modifications could present opponents of the tobacco program with an opportunity to eliminate the program altogether, no other substantial legislative changes were made until 1982. However, by this time some of the domestic and export market was already lost.

Starting in 1982 substantial changes have been made in the tobacco program legislation. At this time there was growing dislike for the government losses on the tobacco price support program. Another concern was that U.S. tobacco was losing its competitiveness in world markets, as a result of escalating price supports.

To address the concern about government losses, the "No-Net-Cost Tobacco Program of 1982" was passed. It required that, to be eligible for price support, producers of all kinds of tobacco, beginning with the 1982 crop, must contribute to a fund to assure that the loan program operates at no net cost to the government (except for administrative expenses).

The level of the "no-net-cost" contribution is based on projected losses in operating the program. The assessment level is set yearly and depends on quantities of tobacco under loan, expected loan-takings, interest rates, and other factors affecting loan stocks, and the length of time they might remain under loan. For burley, because of the increased tobacco taken by the pool, the no-net-cost assessment went from 1 cent per pound in 1982, to 5 cents in 1983, and 9 cents in 1984; it was projected to be 30 cents in 1985. The increase of the no-net-cost assessment to this level became a real financial burden to farmers, and a threat to the existence of the program.

Another provision of the no-net-cost law gives the Secretary of Agriculture authority to reduce price support rates—within limits—for tobacco grades that are in excess supply, to make prices more competitive and hopefully reduce tobacco going into the pool.

To further limit prices, legislation passed in 1983 froze 1983 and 1984 tobacco price supports at their 1982 levels. The legislation also included two provisions dealing specifically with burley. One allows the Secretary of Agriculture to reduce burley quotas by as much as 10 percent in any one year, if necessary, to control overproduction; previously, the maximum permitted was 5 percent. The second provision directs that under certain conditions, the Secretary of Agriculture must determine whether imports are interfering with the U.S. price support and production control program. This provision is discussed further under "Trends in World Trade."

Trends In Tobacco Use

According to the USDA, most tobacco grown in the United States is used in cigarettes; however, cigars, snuff, chewing tobacco, and smoking tobacco (pipe and roll-your-own) are also produced. Except for snuff, total domestic consumption of tobacco products declined in 1982 and 1983, was stable in 1984 and is expected to decline again in 1985.

Despite growing cigarette consumption during the period, domestic disappearance of U.S. tobacco declined about one-fourth from 1950 to 1980. The switch to filters, use of sheet tobacco and stems, reduced cigarette circumferences, and puffed tobacco (tobacco expanded to occupy a larger volume) have reduced the amount of tobacco per cigarette. Furthermore, beginning in the late 1960s, a larger proportion of the tobacco used in cigarettes was imported.

The decline in use of domestic tobacco from 1950 to 1980 varied by type of tobacco. Flue-cured tobacco use dropped substantially, while burley use dropped only slightly, because of cigarette blend changes that use relatively more burley. Consumption of all burley tobacco and domestic burley continued a downward trend from 1979 to 1984.

Cigarettes account for 85 percent of the tobacco used in the United States. They also represent most of the sales of U.S. tobacco products, $28.7 billion in 1983, about $9 billion in taxes. U.S. consumers smoked an estimated 600 billion cigarettes in 1983. This was about 5 percent below the previous year and was the largest percentage and absolute drop on record. Consumption per person 18 and older is expected to drop to 3,384 cigarettes by the end of 1985, 24 percent below the 1963 peak.

The large drop in cigarette consumption in 1983 was mainly the result of a 21-percent jump in retail prices for cigarettes, which was triggered by higher federal and state excise taxes on cigarettes. Cigarette prices increased about six times faster than the rise for all consumer items during this period, a major reversal from the price changes of the 1970s, when the overall price index rose more rapidly than cigarette prices.

Cigarette consumption is also diminished by concerns about smoking and its effects on health, as well as an increasing number of state and local laws that prohibit smoking in certain places. These effects, along with higher prices resulting from increased state excise taxes and manufacturing costs, will probably cause further decline of cigarette smoking in 1985.

As in the United States, consumption in some foreign countries that represent major export outlets for U.S. tobacco will grow little during the remainder of the 1980s. This factor, coupled with continued reductions in leaf use per cigarette and the effects of other countries having substantial tobacco production capabilities and lower selling prices than the United States, suggests a very competitive world market for tobacco. Some increase in smoking in third world countries might be expected.

The proportion of U.S. produced leaf in U.S. cigarettes is not likely to increase as long as less expensive imported tobaccos are available. If U.S. prices become more competitive, or if the import picture is changed in a way favorable to the U.S., the proportion of U.S.-produced leaf in U.S. cigarettes would likely rise. Yet, according to the U.S.D.A., the effect on retail prices would be small, since only about 8 percent of the price of a pack of cigarettes reflects the leaf in the cigarette. Consequently, a drop in cigarette leaf prices of 30 to 50 cents a pound from 1984 prices would translate into only a 1- or 2-cent-a-pack drop in retail cigarette prices.

It should be emphasized that cigarette consumption increased dramatically from the 1950s to the late 1970s world wide, but the U.S. did not maintain its share of the world market during this time.

Trends In The World Tobacco Trade

Trends in world U.S. burley trade have not been favorable in the last 10-15 years. Imports of burley tobacco have risen rapidly in the U.S. from less than 1 percent of use in 1970 to 29 percent by 1984. Lower prices and improved quality of foreign tobacco have helped boost imports.

Another reason for the growth of imports was the decline or variation in U.S. burley stocks held under loan before 1982. When stocks were very low U.S. tobacco companies turned elsewhere for tobacco.

Foreign government export subsidies or aid to foreign tobacco growers affect imports in some cases.

The increase in imports of burley, as well as the great volume and sometimes lower quality of tobacco taken under loan in recent years pose very difficult problems for the tobacco industry. Currently, import quotas do not apply to tobacco. Import controls and their potential positive and negative effects have been debated widely.

Tariff rates vary, depending on the form in which tobacco enters the United States. Import tariffs do not affect burley imports significantly because of the draw-back provision, which allows firms importing tobacco to get back the duty if they export tobacco products.

Import controls can be implemented under Section 22 of the Agricultural Adjustment Act of 1933, as amended, if "any article or articles are being or are practically certain to be imported into the United States under such conditions and in such quantities as to render or tend to render ineffective, or materially interfere with, any loan, purchase, or other program or operation undertaken by the Department of Agriculture . . ." Section 22 review of burley tobacco by the International Trade Commission (ITC) was requested and carried out in 1984. Substantial imports had increased loan stocks and the no-net-cost assessment, threatening the price support program. The USDA initiated Section 22 action; however, the ITC did not find material interference. Therefore, import quotas are unlikely at this time. It should be noted that import quotas or barriers can cause retaliation from exporting countries.

The United States is the largest tobacco exporting country in the world. In 1983, U.S. exports of unmanufactured tobacco and tobacco products were valued at $2.65 billion. Imports were valued at $817 million, leaving a trade balance of $1.83 billion.

Though the U.S. remains the largest exporter, its share in the world market has declined significantly.

U.S. burley production has remained fairly constant, while world production has increased 83 percent since the late sixties. Leading exporters to the U.S. are Brazil, Greece, Italy, Korea, and Mexico. Malawi, the Phillipines, Mexico, Brazil, and Korea lead in growth of burley exports. The United States accounted for 25 percent of total exports of burley in 1982, down from 60 percent in the late 1950s.

A major factor in the U.S. export decline is relative prices. Other factors have weakened U.S. exports, such as weaker global demand, large foreign overseas supplies, higher quality of these supplies, the strong U.S. dollar, and reduced foreign currencies available to potential importers. With large foreign supplies available and with several countries having the capacity to produce greater amounts of tobacco, long run U.S. export prospects are not bright unless the gap between U.S. and foreign prices narrows. Recent freezes in burley price supports don't seem to have eliminated the price competition problem.

Regarding foreign exports, there have been charges that burley tobacco that is imported into the U.S. is heavily subsidized. According to the USDA, tobacco production and cigarette output are controlled to varying degrees by government monopolies or large multinational firms in many foreign countries.

Also according to the USDA, government support has helped boost foreign production and exports in some countries. Because agriculture is subsidized in various ways in many other countries, it's sometimes hard to assess tobacco subsidies. Argentina subsidizes growers by returning to them part of the taxes on cigarettes. South Korea and a number of European countries also provide subsidies to growers. Brazil, a major competitor of the United States, provides technical assistance to growers and manufacturers. Furthermore, some multinational tobacco companies assure Brazilian tobacco growers a market for some of their production. For a number of years, U.S. companies have encouraged burley production in other countries. This burley may be exported or used to manufacture cigarettes at the company's facilities in those countries. Burley production has been encouraged in Guatemala and other central American countries by American companies. Kentucky farm leaders have claimed that they are competing with growers paying little more than slave labor in some foreign countries.

Some major exporters, such as Mexico, do not offer significant export subsidies. Some countries have trade missions like the U.S. that travel throughout the world to promote tobacco. Non-tariff trade barriers that include bilateral agreements, preferential memberships in trade associations and regulations which require mixing indigenous tobaccos with imported leaf also contribute to America's export losses.

Present trends in world burley trade indicate the present re-evaluation of U.S. burley policy and pricing is overdue. Present efforts to lower U.S. prices and to make other program changes, along with sound import policies, may reduce imports and increase U.S. exports and reverse the trend in reduced quotas.

Effects of Recent Developments on Burley Tobacco Production

Worldwide tobacco consumption is stagnant and new technologies are reducing the amount of tobacco needed per cigarette. Relatively high price supports in the U.S., the strong dollar, and other factors have made it possible for other tobacco-producing countries to make very substantial inroads in burley production.

The U.S. export share in world burley tobacco trade has fallen dramatically (Figure 1) and imports have risen tremendously in the last 20 years (Figure 2).

Growing imports and slow U.S. sales have caused loan stocks taken by the "pool" to rise drastically, from virtually none in 1980 to 570 million pounds in 1985, pushing the no-net-cost assessment to almost unbearable levels, thereby threatening the price support program. In order to reduce loan stocks, U.S. marketing quotas have been reduced (Figure 3). Quotas were reduced 5% in 1983, 10% in 1984, and 10% in 1985. The decline in farmers' quotas and the failure of the U.S. to maintain its share of the world market have worked together to reduce American burley production.

With large quantities of tobacco under loan, the prospects for the "no-net-cost" assessment to continue to increase are obvious, if attempts to salvage the price support program are not successful.

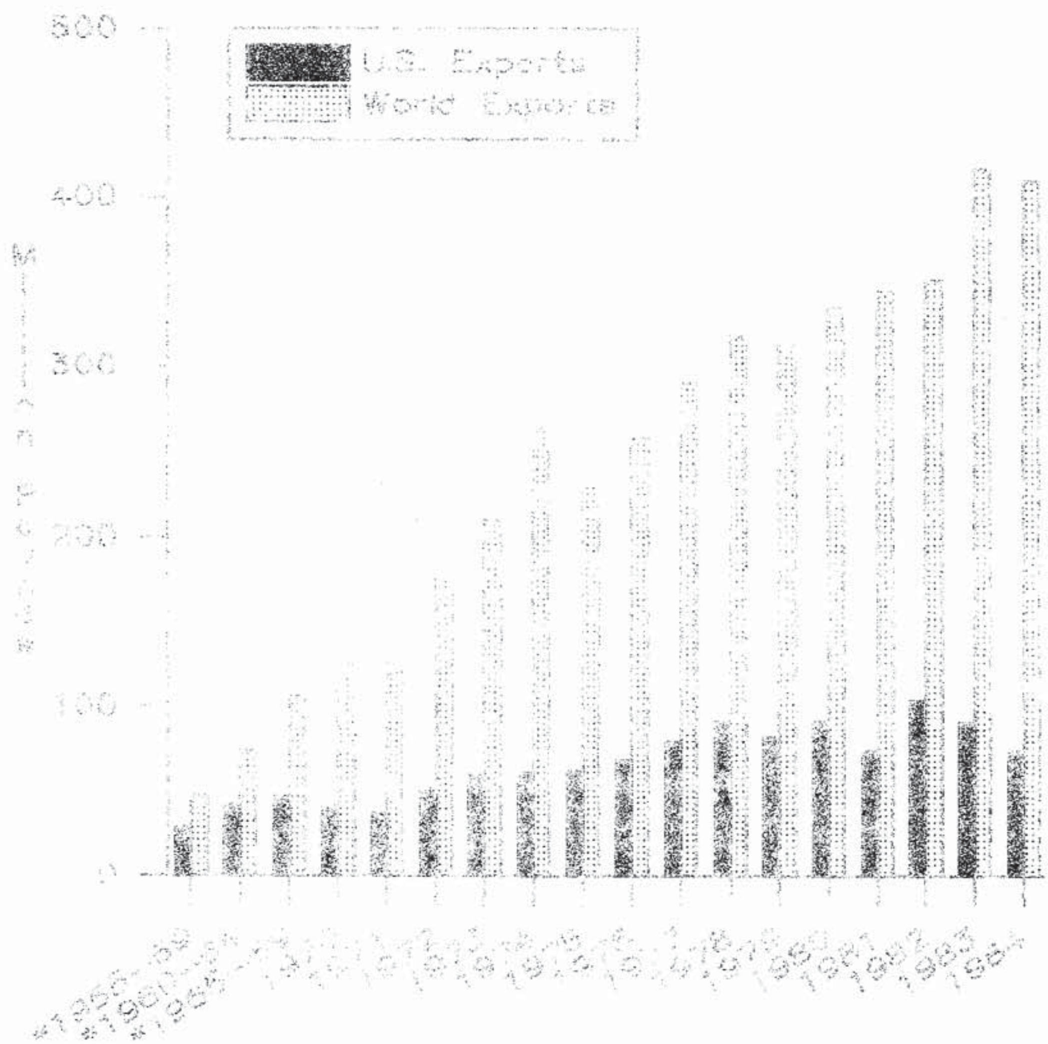
Late in 1985, a stopgap measure passed Congress which would lower the price support and the no-net-cost assessment for this year. S.1418, which would provide more of a long-term solution to the price support program's problems, was still stalled at that time. The no-net-cost assessment was set for 30 cents for 1985 before the interim legislation was passed, and according to some sources, it could go substantially higher in 1986 if the program is not changed by S.1418 or voted out by farmers.

In the 1960s and 1970s, tobacco consumption increased dramatically but, as has been mentioned, the U.S. failed to maintain its share of the world market increase. Relatively high U.S. price supports, stagnant world demand, and increased foreign competition have resulted in increased imports, only stable exports, and reduced quotas for burley farmers. This trend must be reversed, in order to increase U.S. sales and quotas. Unless this is done, economic prospects for U.S. tobacco production for the remainder of the decade are not bright. The price support program must be salvaged, pool stocks reduced and sales invigorated. The lowering of the support price at the end of the year was an attempt to achieve some of these goals. Passage of more long-term legislation remains necessary.

Figure 1

WORLD BURLEY EXPORTS
1955–1984

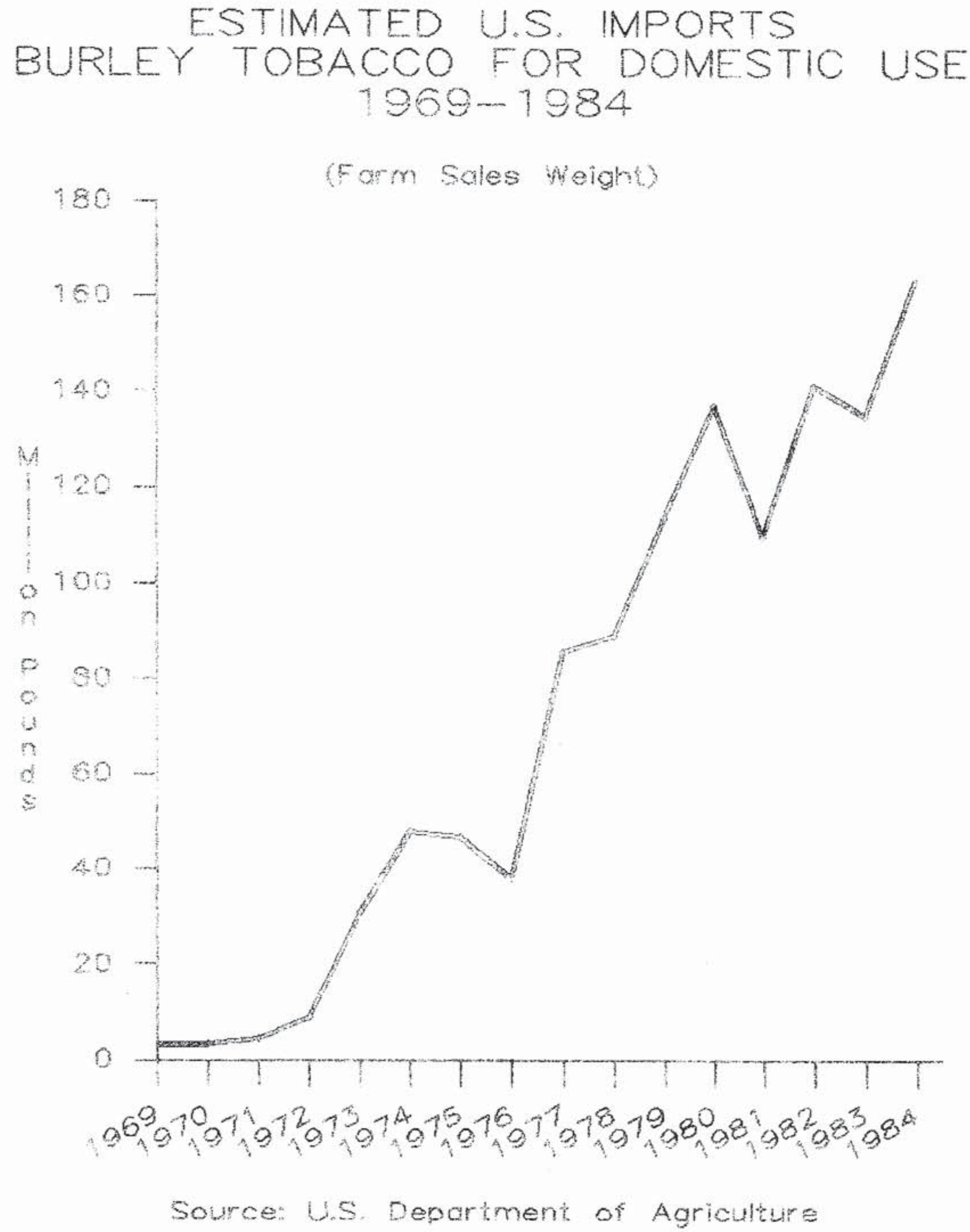
(Unmanufactured export weight)



* Indicates average for period

Source: U.S. Department of Agriculture

Figure 2

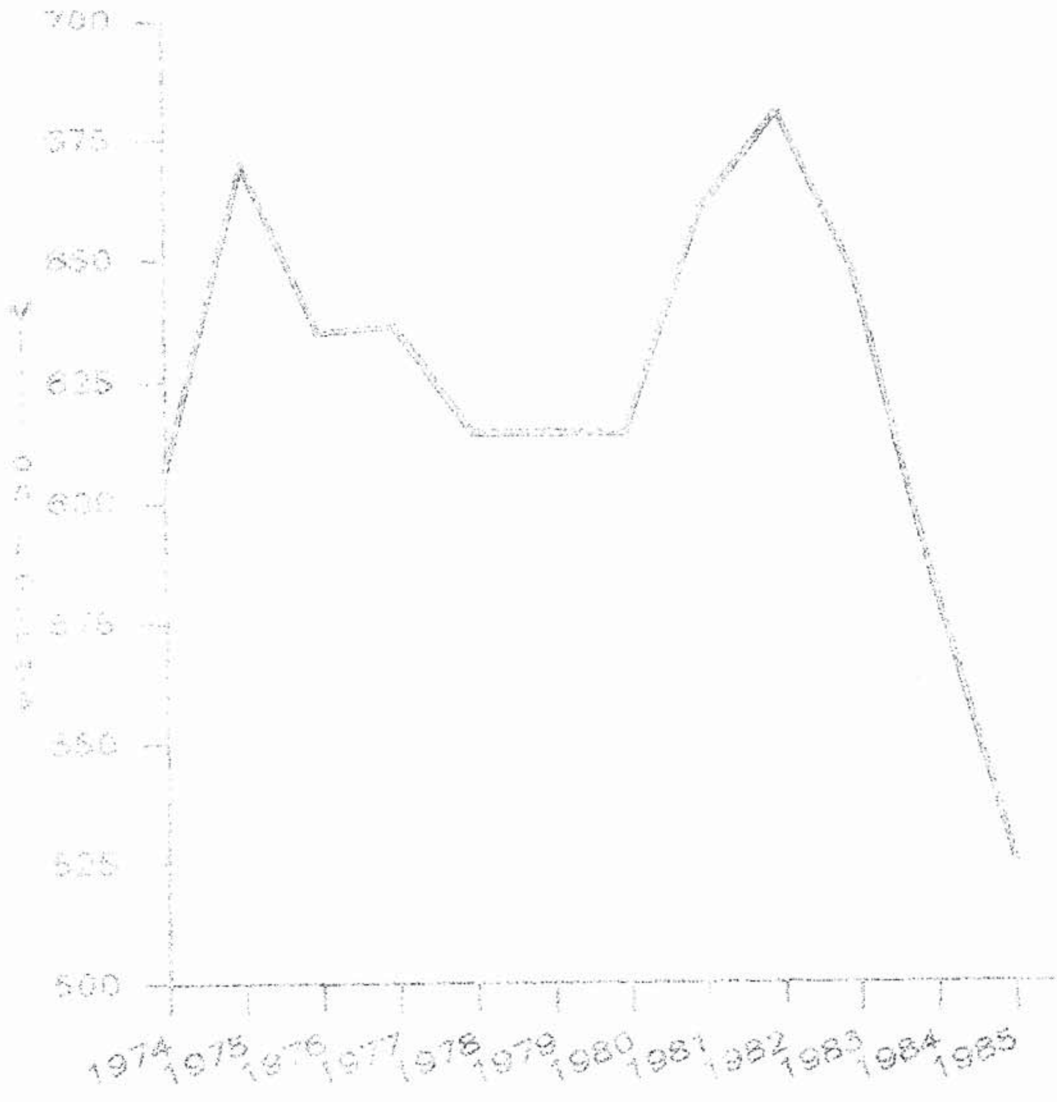


Source: U.S. Department of Agriculture

Figure 3

BURLEY MARKETING QUOTAS
1974–1985

(Farm Sales Weight)



Source: Agr. Stabilization & Conservation Service

Economic Impact of Tobacco on Kentucky

The tobacco program, with its quota system, is the backbone of Kentucky's small farm economy. Without it, farming in Kentucky would be grossly changed and impoverished. Almost 72 percent of Kentucky's tobacco farmers depend on tobacco for at least half of their gross farm sales. Tobacco accounts for 1/2 of the crop receipts in the state. Because of tobacco's central economic role in Kentucky, the Tobacco Task Force commissioned a study, *The Impact of Tobacco on the Kentucky Economy*, shortly after it began its work. The study is included as Appendix 3. The following information is drawn from that report.

Among the report's conclusions were that the total full-time employment attributable to tobacco production is [illegible], 4.1 percent of Kentucky's total employment. The peak employment during housing season is over [illegible]. Given that a large portion of tobacco farmers and workers are older, have relatively little education, and have few skills in other areas of employment, any decrease in tobacco production would harm an already depressed and vulnerable sector of the state's economy.

The total value of Kentucky's 1984 crop was around $[illegible]. The direct income to farmers from the crop was around $[illegible]. Including indirect income, the total income attributable to tobacco was almost $2 billion.

A significant portion of Kentucky's farm real estate value is attributable to tobacco. Part of that value reflects [illegible] high value per acre [illegible] land would have little (or at least, much less) value in other uses. [illegible] attributable to the tobacco support program itself has been calculated at [illegible] billion. [illegible] the benefits tied directly to a particular piece of land and is capitalized into the value of that land, elimination of the program would reduce the value of Kentucky's agricultural real estate by $[illegible] billion.

Tobacco production was shown to generate [illegible] billion to Kentucky residents. This represents an income tax yield to the state of $[illegible].

The sales tax contribution of tobacco to the state is calculated to be $[illegible]. This is general sales tax only and does not include direct taxes on cigarette sales.

Also, assuming that income from tobacco is spent similarly to income from other sources, tobacco production accounts for approximately $[illegible] in other income-related tax revenues.

The state property tax contribution due to the tobacco program is estimated at $3.3 million. Tobacco also makes a contribution to the state's property tax, both directly through tax on tobacco land, and indirectly, as tobacco income supports a higher level of prosperity generally.

Thus, the total state revenue for 1984 generated from tobacco production is estimated to be $129,430,000.

Local governments receive $5.5 million in property tax revenue from the value of the quota system alone.

In regard to farm credit, the Kentucky farm economy has experienced a crisis less serious than many other agricultural states as a result of tobacco income. Tobacco has helped to stave off increases in low income assistance programs and tax increases.

Elimination of the program would result in the loss of $1.5 billion of asset value to Kentucky landowners. Even farmers who are now reasonably well-off would find themselves suddenly in debt beyond their net worth, as a large portion of their land assets vanished. Loans would have to be called and bankruptcies would soon follow. Farm banks in tobacco-growing regions could well find themselves unable to survive.

The study concluded that tobacco is at the heart of Kentucky agriculture and the economy of the state. Eliminating or seriously reducing the tobacco price support program would have a devastating effect on Kentucky and its tobacco farmers.

With the tobacco program in place, but given its present condition, the study projected the trends in 1985. It concluded that the reduced acreage allotments and the increase to 30 cents per pound in the no-net-cost assessment together would reduce direct income from tobacco by $349 million. Employment, taxes and land values would also decline appreciably. From this scenario it is obvious that the Tobacco Price Support program must be revamped soon.

CHAPTER II

THE KENTUCKY TOBACCO TASK FORCE: FORMATION, ACTIVITIES, AND CONCURRENT EVENTS

In the late summer and fall of 1983 and winter of 83-84, Kentucky tobacco farmers were experiencing a disaster. The burley crop was cut almost in half by the most severe drought in years. Government burley tobacco support prices were frozen at 1982 levels, and sales of the drought-damaged crop were only a cent or two above the support price. About half of the crop went into the government pool, swelling the surplus to nearly 400 million pounds. The massive surplus and pool debt were causing quantum increases in the no-net-cost assessment. One of the most effective and least costly price support programs ever undertaken was threatened with self destruction.

Also at this time, cigarette sales were declining in the U.S., following a doubling of the federal excise tax. Burley exports were relatively static and imports increased, taking more than 20% of the domestic market.

As the 1984 Kentucky General Assembly began, the demise of the tobacco price support system seemed very possible. Responding to this situation, the Kentucky House of Representatives passed House Resolution 51 (Appendix 1), which would set up a task force to study the tobacco program. The Legislative Research Commission confirmed this "no-net-cost" tobacco program task force and later, because of the comprehensive nature of the task force's activity, renamed it the Tobacco Task Force. The goal of the Tobacco Task Force was to improve the outlook for tobacco production. The task force decided to conduct a comprehensive review of tobacco programs and their effect on tobacco producers and the economy of Kentucky. This review would include a look at the price support program, the no-net-cost assessment program, functioning of the burley cooperatives, tobacco imports and foreign production, and a study, *The Impact of Tobacco on the Kentucky Economy*. This study is discussed in Chapter I of this report.

The task force contacted numerous government agencies, farm organizations and farmers, and maintained an ongoing consultation with the state's congressional delegation, in order to contribute to the maintenance of a viable tobacco program. The task force, made up of eighteen legislators (see Appendix 2), met twenty-four times through December 1985 and held seven public hearings across the state, to gather the views of farmers and other experts on the tobacco program. The following recounts some of the task force's activities, observations, recommendations, and conclusions.

The task force began meeting September 18, 1984, and elected Representative Butch Burnette as its Chair. At that time, it identified two central problems of the tobacco program: the increasing no-net-cost assessment and tobacco imports. The task force then began to solicit information and invite speakers to address various problems the tobacco program faced.

The task force's perception of the program's most pressing problems prompted it to invite Jim Davis of the U.S.D.A. to its October 4, 1984 meeting, to discuss the operation of the no-net-cost program. Mr. Davis said that the "No-Net-Cost Tobacco Act of 1982" required tobacco producers to contribute to a fund to reimburse the federal Commodity Credit Corporation for any losses sustained from the operation of the tobacco price support program. The assessment services and reimburses the debt for tobacco purchased by the tobacco cooperatives and held in the "pool." Because of the vast amount of burley tobacco that has gone into the pool since 1982, the no-net-cost assessment is rising rapidly. The assessment was 1 cents per pound in 1982 and was projected to be 30 cents per pound in 1985. This would mean that farmers would have to pay 30 cents for every pound of tobacco they sold in 1985. The role of tobacco imports, the role of foreign countries subsidizing their tobacco exports, and the role of American companies supporting growth of tobacco in foreign countries were also brought up at this meeting. Increasing imports and no-net-cost assessments were destroying the tobacco program and would continue to be primary concerns of the task force.

A detailed analysis of how the assessment is derived was undertaken by the task force. Data and assumptions involved in the no-net-cost assessment calculation are included in Appendix 4. Information on the operation of the Burley Tobacco Growers Cooperative Association, Inc., involved in the use of the assessment is included in Appendix 5.

Through its meetings and public hearings in November and December 1984, the task force gathered information on possible solutions to the tobacco program's problems. The task force decided to appear before the International Trade Commission (ITC) on January 3, 1985, to present testimony in favor of import restrictions (see Appendix 6). The testimony called for the President to take immediate legal action, under Section 22 of the "Agricultural Adjustment Act," to reduce tobacco imports on the basis of the fact that they render the tobacco price support program ineffective. Among the reasons cited were the lack of production controls on foreign burley, in contrast to controls on burley production in the U.S., and the adverse effect of imports on pool stocks and the no-net-cost assessment. Further recommendations to the President were that:

> The United States should not allow tobacco imports from those countries which do not allow American tobacco into their countries.
>
> The United States should not allow tobacco imports from those countries which subsidize the production or manufacturing of tobacco.
>
> The United States should not allow imported tobacco which does not meet the same pesticide and herbicide requirements which American-produced tobacco must meet.

Imported tobacco should be charged a single rate of duty for each pound, regardless of the classification.

Imported tobacco should not be allowed from nations who do not allow a fair and just market for American products.

Against the advice of the task force, the USDA and others, the ITC later ruled against any import restrictions on tobacco. While in Washington, D.C. to testify before the ITC, members of the task force also met with Secretary of Agriculture John R. Block regarding the problems the tobacco program faced. It followed up at its January 28, 1985 meeting with a letter to Secretary Block and President Reagan expressing the task force's displeasure with the administration's proposal to abolish the tobacco price support program.

Following up on one of its recommendations to the ITC regarding pesticides on foreign tobacco, at the March 12, 1985 meeting of the task force members voted to support S.67, introduced before the U.S. Congress by Senator Gore. This bill would prohibit the importation of tobacco on which pesticides and chemicals prohibited in the U.S. have been used. The legislation would protect the health of Americans by preventing the use of unsafe pesticides on imported tobacco and would protect American farmers from unfair competition resulting from the use of inexpensive pesticides and herbicides banned in this country. The task force had also requested documentation as to pesticide and insecticide testing procedures used on foreign tobacco in a September 1984 letter to the General Accounting Office. A response was received in March which stated that "there are no tests performed on imported tobacco by the Agriculture Marketing Service to determine whether pesticides or insecticides have been used."

Also in that correspondence regarding imports, the task force asked for information regarding volume, grading procedures, country of origin and whether slave labor or forced labor is used to produce the tobacco by companies and countries. The GAO responded that, according to the Foreign Agricultural Service, in 1983, 5,567 metric tons of burley leaf were imported; among the main suppliers were Brazil and Canada. FAS also reported that an additional 95,279 metric tons of machine threshed tobacco—a combination of flue cured and burley—was imported. According to the GAO, prior to July 1984, imported tobacco was not graded, but under the provisions of the Tobacco Adjustment Act of 1983 all imported tobacco will now be graded. Regarding use of slave or forced labor, the GAO replied that no audit work had been done relative to that issue.

Also at the March meeting, task force members observed that they had noticed in their public hearings a cooperative spirit among producers and that a consensus seemed to be developing on how to deal with the price support program. Elements of a plan to cope with the tobacco program's problems were coming together. At this meeting, task force members moved to look into a plan which the burley cooperatives and others were trying to work out with R. J. Reynolds Tobacco Company aimed at salvaging the tobacco price support program. As the plan evolved, it was followed closely by the task force. Senator Wendell H. Ford appeared before the task force on April 9 and discussed the "Reynolds Plan."

The importance of the tobacco issue and the concern of Kentucky farmers was evident throughout the task force's hearings, but became most apparent when nearly 1000 people attended the March 25 hearing in Hardinsburg. A summary of comments made at the public hearings is in Appendix 7.

One of the real highlights of the task force's work was the Tobacco Conference of the States, held April 19-21 in Frankfort to promote a unified effort of the tobacco-producing states to save the tobacco program. This conference brought state legislators together from nine tobacco states in an unprecedented show of unity and support for the tobacco program. Legislators from areas that grow flue cured, burley and other tobaccos worked closely together. Larry Forgy of the Burley Tobacco Growers Coop, Representative Charlie Rose, and Senator Wendell Ford spoke at this conference. The conference concluded with the adoption of a resolution by the states to create a permanent Tobacco States Conference, which would proceed with unity to work out details necessary to save the tobacco program. Kentucky further supported the following Plan of Unity and Action:

> That manufacturers along with producer representatives be encouraged to enact a plan to minimize the growers' no-net-cost, reduce tobacco imports, and increase the world-wide market share. These were among the goals examined in the development of the "Reynolds Plan" and later S.1418 "The Tobacco Program Improvement Act of 1985."
>
> If no agreeable plan is forthcoming from Congress, the task force hereby supports a federal tax on cigarette manufacturers to pay for the cost of the no-net-cost program in support of tobacco farmers (like Congressman Rose's bill, HR 2600, to be discussed later).
>
> If a federal excise tax as described above is not forthcoming, then the task force supports a state level manufacturers' tax on the cigarette industry to support the no-net-cost program for tobacco farmers.

North Carolina and Virginia to a lesser degree adopted similar statements (see Appendix 8 for all three statements).

As a result of the conference, other states followed Kentucky's lead and formed permanent legislative tobacco groups which continued to work with Kentucky on behalf of tobacco through the year.

The Kentucky Task Force members met later in the year with other Tobacco States Conference members and a future conference is planned in North Carolina. Because of the continuing problems that face tobacco, it is the task force's view that Kentucky must continue to initiate efforts on behalf of the tobacco program and the Conference and each states's organizations should continue to function and be on call whenever action is needed.

In May, Representatives Burnette, Crupper, and Worthington met with the President of Philip Morris, Inc. to discuss concerns Philip Morris had over possible antitrust implications of participating in the buyout proposal in the "Reynolds Plan." Following this meeting and assurances from the Congressional Research Service and others that there would be no antitrust problems, Philip Morris overcame its reservations and joined in negotiations regarding the "Reynolds Plan."

At its May 7 meeting, the task force passed a resolution requesting that Kentucky's Congressional Delegation introduce legislation—along the lines of the "Reynolds Plan"—resolving problems in the tobacco price support program.

At the May 30 meeting of the task force, draft legislation was revealed which would impose a state manufacturers' tax on cigarettes, to be used to reduce producers' no-net-cost payments (option #3 from the plan of Unity and Action from the Tobacco Conference of States). Task force members noted that the tax would be a last resort, and that the bill was intended to encourage more desirable resolution of the price support program problems.

On June 5, tobacco growers and cigarette companies reached a compromise, based on the "Reynolds Plan," that was designed to lead to legislation which would help the ailing tobacco price support program. The agreement would lower the price support for burley by about 30 cents, to $1.45 per pound. The no-net-cost assessment would be shared 50/50 between growers and tobacco companies, and a buy out by the companies of surplus burley in the pool over five years was proposed. The Commodity Credit Corporation would take title to the 1983 "disaster" crop and offer it for sale. Any 1983 stocks not sold in two years could be sold at 10% of the Tobacco Association's costs. Marketing quotas would be determined by using projections of the amount of tobacco manufacturers intended to purchase; some adjustments could be made by the Secretary of Agriculture.

At the June 13 task force meeting, proposed federal legislation (the Tobacco Program Improvement Act of 1985, S.1418—see Summary in Appendix 9) which would incorporate the abovementioned elements of the "Reynolds Plan" was discussed by David Beck of the Kentucky Farm Bureau. Mr. Beck stated that neither growers nor the Farm Bureau got everything in the legislation they wanted, but that keeping the program was so important that major compromises were necessary. He said that if the compromise wasn't adopted, the tobacco program's situation would deteriorate: the no-net-cost assessment would go up, quotas would be cut, and the program might be voted out by farmers.

Task force members generally responded positively to the proposed legislation, but recommended in a letter to the Congressional delegation that if the price support is rolled back 30 cents, farmers should not be required to pay half the no-net-cost assessment. They also recommended that imports should be dealt with more extensively in the legislation. They expressed concern about the 1983 crop being sold for 10 cents on the dollar and suggested that farmers should have first refusal to purchase this pool tobacco and, if they chose, destroy it and add this poundage to their quota for future crop years. The provision which would allow tobacco manufacturers' projected needs to form the basis of quotas also concerned the task force members. They pointed out that the formula used to calculate the support price could suppress the price in future years. Also in this communication, they maintained that the proposed 30 cents no-net-cost assessment was high enough for this year and should be lower in 1986.

Before their next task force meeting, members of the task force attended the Southern Legislative Conference (SLC) and met with Tobacco States Conference legislators. Tobacco States Conference legislators agreed to continue to meet, and attempt to place a tobacco representatives from several states on the Agriculture and Food Policy Committee of the National Conference of State Legislatures (NCSL) to assure national coverage of tobacco concerns. Representative Ramsey Morris was already a member of this committee. The SLC passed a resolution to urge the federal government to continue the tobacco price support and quota programs.

Task force members met again with other Tobacco States Conference legislators at the NCSL Conference in Seattle later in the year.

At their July 29 meeting, the task force heard testimony supporting Congressman Rose's bill (HR 2600), mentioned earlier. The "Rose Bill" would use part of the present federal excise tax on cigarettes to replace part of the no-net-cost assessment. The tax could be adjusted to reflect government losses according to the Cooperative's loan stock levels. This approach to dealing with the tobacco program problems had been cited by the task force as its second choice, a less comprehensive solution, than the "Reynolds Plan" (S.1418).

At this time, S.1418 was stalled in Congress and administrative steps to address tobacco problems were being considered by the flue-cured tobacco industry. In July the U.S. Department of Agriculture and the Flue-Cured Tobacco Cooperative Stabilization Corporation reached an agreement to reduce the effective support price for the 1985 flue-cured market. The results of this activity were followed closely by the Tobacco Task Force. The plan was conceived to encourage purchase of more tobacco by companies, allowing less to go to the pool and to dispose of some of the pool stocks. This action was also seen as removing a stumbling block to the passage of S.1418, by preventing more tobacco from going into the pool.

Under the plan, a 5 cents price reduction and 10 cents rebate to the purchaser were offered on all tobacco purchased. In addition, if more than 650 million pounds of this year's crop and 125 million pounds of pre-1982 loan stocks were bought, an additional 15 cents would be rebated on this year's crop purchases. This action would take from the no-net-cost fund $66.1 million for the first rebate and $99 million for the second rebate. As it turned out on the 1985 market, less flue-cured tobacco was sold, and that at a substantially reduced price ($1.72 before rebate, $1.47 after), with about the same amount going to the pool as last year. Last year's price was $1.81.

There was a general feeling among task force members that the flue-cured rebates had not worked very well to achieve their goal. The task force questioned whether it was advisable for the burley market to consider similar rebates. Administrative action taken by the flue-cured market would deplete the 1985 no-net-cost assessment and only take care of 125 million pounds of loan stocks. The no-net-cost fund loss would have to be made up by farmers, if S.1418 did not pass. During dicussion of the flue-cured action, Representative Worthington said it appeared that the administrative action would encourage buyers to purchase some loan stocks but would allow much of this year's crop to go into the pool. He concluded that it might be possible to alleviate the problem of excess loan stocks administratively, but the approach taken by the flue-cured market did not appear to be very effective. Worthington also concluded that the flue-cured action only seemed to help the tobacco companies. Responding to task force inquiries, the Flue-Cured Cooperative Stabilization Corporation suggested that export purchases had been stabilized or increased because of the administrative action and said that there was an upturn in sales from earlier in the marketing season.

Somewhat similar administrative action for the burley market was being planned but became unnecessary when a stopgap measure to lower burley prices passed the Congress in November. S.1418, the more long-term solution, was stalled—attached to a budget reconciliation bill—so that if it were passed, it wouldn't take effect until 1986-87 sales. The stop-gap tobacco bill would lower the price support level for the 1985 burley crop by 30 cents from just under $1.79 to $1.49, and it is generally viewed as a major step in saving the price support program. The legislation would decrease the no-net-cost assessment from 30 cents to 4 cents.

The measure was designed to reduce the amount of tobacco going into the pool this year, limiting loan expenses of the pool and making it easier for tobacco companies to buy out stocks next year. This action would be complementary to, and require passage of, S.1418. The stop-gap measure did not address stocks already under loan. Unless S.1418 passes, taking care of old loan stocks and providing for sharing of the no-net-cost assessment with tobacco companies, the no-net-cost assessment for 1986 could become much higher, since the 4 cents no-net-cost assessed under the interim measure wouldn't pay for past surpluses. Thus passage of S.1418 is still viewed as essential.

The burley market opened November 25th and the task force attended sales at three warehouses in Shelbyville on the 26th.

As the marketing began, tobacco was selling for around $1.60 per pound. This was $.28 per pound below last year, but when the no-net-cost differences are considered—9 cents in 1984 and 4 cents this year under new legislation—the difference is $.23. According to the *Lexington-Herald*, this difference would mean a $90 million loss for Kentucky's 150,000 tobacco farmers.

But the Burley Tobacco Growers Cooperative is quoted as saying they expect less than 10% of this year's 525 million pound crop to go to the pool. This is good news for farmers, since the pool would be burdened with less surplus this year, helping provide for a long-term solution for the price support program, if S.1418 or some similar measure becomes law.

At this writing, the deficit reduction measure to which S.1418 is attached had failed to get out of Conference Committee before Congress adjourned for 1985. This measure may not pass before burley tobacco farmers are scheduled to vote on whether to continue the federal tobacco program in February or March. It has been the aim of tobacco state congressmen to have S.1418 in place before this time. Attachment of S.1418 to a new legislative vehicle might be possible early in 1986. Yet real uncertainty faced the program at the end of 1985. The price of tobacco remained around $1.60 per pound and 11.7 percent of the crop was going to the pool.

APPENDIX 1

IN HOUSE

REGULAR SESSION 1984

HOUSE RESOLUTION NO. 61

TUESDAY, FEBRUARY 14, 1984

Representative Ward Burnette introduced the following resolution which was ordered to be printed.

A RESOLUTION relating to tobacco.

WHEREAS, the Commonwealth of Kentucky and her people feel the burden of these hard times; and

WHEREAS, the people recognize the need for a strong and vibrant agriculture; and

WHEREAS, the Secretary of Agriculture of the present federal administration has announced a 10 percent reduction in 1984 quotas for burley tobacco after the shortest crop on record; and

WHEREAS, the economic impact upon the Commonwealth of Kentucky, and her people will be devastating; and

WHEREAS, the present tobacco program, after many years of successfully serving its purpose to the people, has been altered to such an extent that it will destroy the livelihoods and hopes of a large segment of the people; and

WHEREAS, the imports of high-grade burley tobacco under the clever disguises of other lower quality grades as allowed by law are creating havoc within the Commonwealth of Kentucky's economy; and

WHEREAS, the imports of high-grade burley leaf are subsidized by the no-net cost program and bring to bear undue hardship upon our producers; and

WHEREAS, the Kentucky burley tobacco grower is being subjected to unfair treatment in the market by this deliberate attempt of the USDA to dismantle and destroy the tobacco program;

NOW, THEREFORE,

Be it resolved by the House of Representatives of the General Assembly of the Commonwealth of Kentucky:

Section 1. That the 1984 General Assembly of the Commonwealth of Kentucky demand an accounting by those USDA officials and elective bodies responsible for this destructive and subversive attempt to destroy the number one cash crop of Kentucky farmers.

Section 2. That the 1984 General Assembly of the Commonwealth of Kentucky issue a plea to the USDA and Congress for an economic impact study upon the producers and their communities.

Section 3. That the 1984 General Assembly of the Commonwealth of Kentucky establish a task force to determine the impact the no-net cost program will have upon the producers, both short-term and long-term.

Section 4. That the 1984 General Assembly of the Commonwealth of Kentucky petition the General Accounting Office of the U.S. Government for documentation as to the volume of imports, grading procedures, pesticide and insecticide testing procedures of foreign leaf, country of origin, and whether slave or forced labor is used to produce tobacco by companies or countries.

APPENDIX 2

Tobacco Task Force

Representative Ward Burnette, Chair
Representative Adrian Arnold
Senator Fred Bradley
Representative Paul Clark
Representative Mark Farrow
Senator Ed Ford
Senator Helen Garrett
Representative Donnie Gedling
Representative June D. Lyne
Senator Danny Meyer
Senator Pat McCuiston
Representative Harry Moberly
Representative H. Ramsey Morris, Jr.
Senator Doug Moseley
Representative Lonnie Napier
Representative Charles L. Siler
Senator John "Eck" Rose
Representative Pete Worthington

APPENDIX 3

LEGISLATIVE RESEARCH COMMISSION

State Capitol Frankfort, Kentucky 40601 502-564-8100

MEMORANDUM

TO: Representative Donald J. Blandford
Senator Joseph W. Prather
Co-Chairmen, Legislative Research Commission

FROM: Representative Ward "Butch" Burnette, Chairman
Kentucky Tobacco Task Force

SUBJECT: Interim Report of the Kentucky Tobacco Task Force

DATE: April 19, 1985

At its August 1, 1984 meeting the Legislative Research Commission authorized the establishment of the Kentucky Tobacco Task Force. The Task Force has been meeting around the state, talking with the various interests and gathering information on the tobacco situation.

After considerable review it was determined that much of the basic information needed to develop recommendations on tobacco's future was not available. To fill that need the Task Force has developed a report on the Impact of Tobacco on the Kentucky Economy. This report presents an extensive analysis of the role tobacco plays in the state's income, employment, tax revenue and related economic issues. Its findings should be of considerable value in arriving at well-reasoned and useful recommendations regarding tobacco.

The principal investigator of this report is Dr. Richard G. Sims of the Legislative Research Commission staff. The Task Force would like to express its appreciation to Dr. Sims and the other members of the LRC staff who aided in the preparation of the report. A special thanks is due to Dr. Milton Shuffett, Chairman of the Department of Agricultural Economics at the University of Kentucky, and the faculty members of his department for their valuable advice and assistance in the preparation of this report.

The Interim Report of the Kentucky Tobacco Task Force is hereby submitted for your consideration.

WB/ps

Tobacco Task Force

Representative Ward Burnette, Chair
Representative Adrian Arnold
Senator Fred Bradley
Representative Mark Farrow
Senator Ed Ford
Senator Helen Garrett
Representative Donnie Gedling
Representative June D. Lyne
Senator Pat McCuiston
Representative Harry Moberly
Senator Doug Moseley
Representative Lonnie Napier
Representative Charles L. Siler
Senator John "Eck" Rose
Representative Pete Worthington

TABLE OF CONTENTS

SUMMARY

In pursuit of its charge the Kentucky Tobacco Task Force has made the following findings regarding tobacco production in the state:

- The direct employment is 30,987 (full-time equivalent). Including the indirect employment effects, the total employment attributable to tobacco production is 54,521 (4.1% of the state total).
- The total value of Kentucky's crop was $938,996,000. This brought a total of $2,385,000,000 to the Kentucky economy (2.9% of the gross state product).
- The direct income of tobacco farmers and farm workers was $453,700,000. Including the indirect effects, the total income attributable to tobacco was $1,937,000,000 (5.5% of the total personal income).
- A one percent loss in tobacco output would mean 545 lost jobs.
- A one percent loss in tobacco output would mean a $23.9 million loss in the state product.
- A one percent loss in tobacco output would mean $19.4 million in lost income.
- $1.5 billion in farm real estate value is attributable to the capitalized value of the income from the tobacco quota system.

- $129.4 million in state tax revenue is related to tobacco production:

  * $53.3 million in income tax
  * $19.5 million in sales and use tax
  * $53.4 million in other general taxes
  * $3.3 million in property taxes

- Local Governments receive $5.5 million in property tax from the value of the quota system alone.

- 1985's crop is likely to be 17 percent smaller because of reduced planting.

- Reduced acreage and the increase in the No-Net Cost assessment together will reduce the direct income from tobacco by $104.6 million (a 23% decline). The overall effect on the state's economy of the reduced acreage and higher program costs would be a loss in income of $495 million.

Tobacco is at the heart of Kentucky agriculture, accounting for more than one-half of the total value of all crops grown in the state. Eliminating or seriously reducing the tobacco program would have a devastating effect on Kentucky and its tobacco farmers. Tobacco is a highly labor-intensive crop and its production is physically very demanding. Tobacco farmers have large capital investments in equipment and land. Tobacco is a billion dollar cash crop in Kentucky. No legal crop can replace tobacco for value per acre.

INTRODUCTION

The current tobacco program has existed in essentially its present form since its inception in the Agricultural Adjustment Act of 1938. The first major revision was the No-Net Cost program of 1982. The General Accounting Office estimated that for the years immediately prior to the No-Net Cost program, the federal administrative costs of the tobacco program ranged from $13 to $16 million per year. Since 1982, U.S. Department of Agriculture expenditures relating to tobacco are estimated to be around $10 million per year. This figure includes Commodity Credit Corporation export financing, agricultural research and extension services. A large part, $6.4 million, is for research related to health issues and developing safer tobacco. Subsidies under Public Law 480 (sales to less-developed countries) are around $1 million a year.

I. KENTUCKY'S TOBACCO HERITAGE

The cultivation of tobacco in the United States stems from the earliest colonial times. Virginia, the site of the first permanent settlement, engaged in tobacco production from the beginning. Colonial exports of tobacco grew from a hundred thousand pounds in 1620 to a hundred million pounds just prior to the Revolutionary War. Tobacco cultivation was the most important enterprise in the Virginia and Maryland Colonies. Besides being the chief exported good, tobacco was used as a store of value, and at times a unit of account.

Following the Revolutionary War, the tobacco culture crossed the Appalachians. Just as tobacco had been a prominent factor in establishing the early colonies, it played a major role in the exploration and settlement of Kentucky. Immigrating Virginians and Carolinians were thoroughly familiar with the culture of tobacco. The exploration of Kentucky was motivated in part by a scarcity of good land in the east. The clearing of trees was followed by the selection of superior soils to be set aside for tobacco. So important was tobacco to the early settlers of Kentucky, that the fertility of the soil was judged by how well it grew tobacco.

The Virginia Assembly on December 18, 1789, passed the Enabling Act, which expressed Virginia's willingness for Kentucky to separate. It was not until June 1, 1792, however, that Kentucky finished preparing her own constitution, and was admitted to the Union as the fifteenth state. One of the first acts of the new General Assembly in

1792 was to adopt the Virginia warehouse system and quality control inspections of tobacco.

By 1810, 42 new warehouses were built along the Kentucky River, with towns growing up around them. Tobacco provided a foundation upon which community expansion was possible by providing employment for farmers, warehousemen, processors, exporters and manufacturers. By 1839, 53 million pounds of tobacco were being produced in Kentucky. Twenty years later her output had doubled. While the Civil War severely reduced tobacco production in most southern states, the upswing of planting in Kentucky was scarcely disturbed.

1904 saw the use of hogheads for transporting tobacco to market begin to go by the wayside. Charles Bahmer introduced in Lexington a loose leaf auction system with graded baskets or trays of several hundred pounds each. First used in Virginia a few years earlier, the innovation proved popular with both buyers and growers because of increased quality control and, for the skilled farmer, better prices. In addition to stimulating the Lexington economy, the shifting of the marketing center there increased commercial diversity, allowing for continued economic growth.

Production grew continuously so that by 1919, 506 million pounds, valued at 116 million dollars, was being produced. That year the golden leaf accounted for almost 1/3 of the state's total crop income. Last year about 1/2 of Kentucky's total crop income was accounted for by tobacco. Besides the income and employment effects realized by Kentucky, the state coffers have historically been well supported by tobacco. Since 1936, when the cigarette excise tax was enacted, that tax on the sale of cigarettes has contributed $472.4 million to the general fund.

Although production improved continuously, growers on both sides of the Appalachians faced difficulty with monopolistic purchasers. Low prices caused great anguish and much agitation. The Lexington market in 1920, and the North Carolina market in 1933, were closed down as a result of depressed low prices. During this area, producer cooperatives became popular. Cooperatives were formed in most major tobacco areas. However, their success was minimal. Without any mechanism to ensure participation of all or at least most of the growers, they had difficulty in controlling the marketing of tobacco. It was not until late 1933, when the Agricultural Adjustment Act was passed, that government control programs came into being. By and large the supply programs which were to follow were successful in raising and stabilizing prices. When the tobacco supply program is compared with other agricultural price support programs, the real price received for tobacco is considerably more stable than those for other commodities. For many years, tobacco has been one of the surest crop investments in U.S. agriculture.

Tobacco now finds itself in less stable waters. Tobacco farmers face the same problems that besiege the agricultural economy generally---falling farm land prices, record high "real" interest rates, reversals in the farm credit industry, and a radical shift in goverment's attitude toward farming. In addition, Kentucky burley farmers have been hit particuliarly hard by export losses, declining cigarette sales, and increased use of imported tobacco.

The Kentucky tobacco tradition is a long one. It cannot be expected that major changes can be made without severe disruptions.

II. THE CURRENT ECONOMIC SITUATION

Kentucky Tobacco Producers

Any decline in the prospects for tobacco will have an adverse and possibly disastrous effect on Kentucky tobacco farmers. Almost 72 percent of Kentucky's tobacco farmers depend on tobacco for at least 50 percent of their gross farm sales. Seventy-six percent of Kentucky's tobacco farmers have a net annual farm income of less than $10,000. Forty-seven percent of Kentucky tobacco farmers have an annual total family income of less than $20,000. Sixty-one percent of Kentucky tobacco farmers are 46 years of age or older, 83 percent grew up on the farm, and 44 percent have less than a high school education. These figures indicate that the Kentucky tobacco farmer is strongly attached to farming and a change in vocation brought about by the demise of the tobacco price support program would be extremely difficult for him.

Economic Impact of Tobacco on Kentucky

The number of full-time equivalent tobacco production workers in Kentucky is 30,987. These are farmers and hired workers engaged in tobacco production. However, the peak farm labor employment during the tobacco housing season in October is 84,114. These eighty-four thousand workers are directly affected by any reduction in the current tobacco program. At its peak, tobacco is Kentucky's fourth largest industry, behind only government, manufacturing, retail trade and the service industry.

In 1984, the total value of tobacco production in Kentucky was $938,996,000.

In 1984, Kentucky farmers and farm workers received an estimated net income from tobacco of $541,065,000.

To evaluate the economic impact of the tobacco industry on the state it is necessary to consider the effect that tobacco has on other industries, as well as the direct effect of the industry itself. A 1983 study conducted at the University of Kentucky estimated tobacco's indirect impacts (impacts on industries that supply the tobacco industry with products or materials) and its induced impacts (those that result as tobacco income is respent in the state's economy). This extensive analysis of the Kentucky economy shows that the total full-time equivalent employment attributable to tobacco production is 54,521, 4.1 percent of Kentucky's total employment.

The value of output in the state attributable to tobacco production (gross state product), either directly or through secondary effects, was found to be $2,385,050,000, 2.9 percent of the total gross state product of Kentucky.

In terms of income, the total personal income generated in the state traceable to the tobacco industry is $1,937,013,000, or 5.5 percent of the total income of Kentucky's citizens.

Thus, even a loss of one percent in Kentucky's tobacco output would result in 545 jobs being lost by a hard pressed sector of the state's economy.

A one percent decrease in tobacco output would result in a $23,850,000 decrease in the value of the total state product.

Finally, a one percent decrease would correspond to $19,370,000 in lost income to the citizens of the state.

Given that a large portion of tobacco farmers and workers are older, have relatively low education, and have few skills in other areas of employment, any decrease would harm an already depressed and vulnerable sector of the state's economy.

Tobacco is by far Kentucky's largest cash crop, accounting for more than 50 percent of the total crop receipts of Kentucky farmers.

Tobacco production accounts for over 12 percent of the employment in 10 of Kentucky's counties. These counties are among the poorest in the state, including the two poorest. All of these tobacco-producing counties earn less than the average per capita income in Kentucky, which is the 5th lowest state in the nation. At the same time, these counties have high unemployment rates, currently averaging over 14.6 percent.

Property Value

A significant portion of Kentucky's farm real estate value is attributable to tobacco. Part of that value reflects tobacco's high value per acre and the fact that much tobacco land would have little (or at least, much less) value in other uses. The other part of tobacco's contribution to real estate value is tied directly to the tobacco production control program, which restricts the right to grow tobacco to certain specified parcels of land.

The value added to real estate because of the high productivity of tobacco is not measurable but would certainly be significant, particularly for land that would otherwise have little agricultural use. The real estate value attributable to the tobacco support program itself may be calculated by taking the net present value of the expected income from a pound of tobacco base and multiplying that times the total pounds. A 50¢ a pound annual income from the tobacco base discounted at 10% per year (an approximation of the interest rate) for 10 years would show that each pound of base is worth $3.00. At Kentucky's 1984 poundage, 498,750,000, this would mean a value of $1.5 billion directly attributable to the program. Since the base is tied directly to a particular piece of land and is capitalized into the value of that land, elimination of the program would reduce the value of Kentucky's agricultural real estate by that $1.5 billion.

State Revenue

In spite of a heavy tax burden on its citizens (Kentucky has the 10th highest tax burden per income of its citizens in the nation) Kentucky is still a tax poor state and its current operating budget has already been cut to the bone. Any loss in tobacco revenues would be immediately felt in cuts in the remaining vital state programs.

Tobacco production was shown above to generate income of $1,937,013,000 to Kentucky residents. At an average effective tax rate of 2.75% this would represent an income tax yield of $53,268,000.

Sales tax receipts tend to be related to the value of products sold in the economy (output). Tobacco production accounted for $2,385,051,000 in total output. Kentucky's effective output-to-sales tax ratio has been found to be .00816. Thus, $2,385,051,000 x .00816 gives a sales tax contribution of $19,462,000. Note that this is general sales tax only and does not include direct taxes on cigarette sales.

In addition to the income tax and the sales tax many other state tax receipts are closely tied to changes in residents' income. It is estimated that for 1984 total collections of these other income-related taxes amounted to around $750,000,000. Tobacco production accounted directly for 1.86% of the state's personal income and indirectly for an additional 5.26%, for a total of 7.12%. Assuming that income from tobacco is spent similarly to income from other sources, tobacco production would account for approximately $53,400,000 of these other income-related tax revenues.

The state property tax contribution from the tobacco support program may be estimated by taking the capitalized real estate value attributable to the program and applying the state property tax rate to that amount. The capitalized property value was found to be $1.5 billion and the 1984 state tax rate is 22¢ per $100 of value. Thus, the state revenue from $1.5 billion in property would be $3.3 million.

There would also be a property tax multiplier effect, as the value of real estate attributable to tobacco supports the general level of prosperity in the community. No attempt is made here to estimate that effect.

Thus, the total state revenue for 1984 generated from tobacco production is estimated to be $129,430,000. This is equivalent to 5.2 percent of Kentucky's 1985 General Fund appropriations.

Local Impacts

Local governments in Kentucky's tobacco producing counties would have significant revenue losses should the industry falter. The property tax in particular would be immediately affected through declining land values should the returns from tobacco growing fall. Of even greater concern is the fact that a large portion of Kentucky's farm real estate value is based on the value of the tobacco quota. If the right-to-grow tobacco were reduced or eliminated, land values would fall dramatically, with resulting losses in property tax revenues. Since Kentucky's local governments count on the property tax for the majority of their locally generated revenue, the result could be disastrous in tobacco counties. Local education efforts could be seriously jeopardized. The tobacco counties are already characterized by high unemployment and low average income, and few options would exist for replacing that lost revenue.

Local property tax rates vary among counties and school districts but average around 17.9¢ per \$100 assessment for counties and 18.7¢ per \$100 for school districts, with the state rate of 22¢ generating \$3.3 million in state revenue (from the previous analysis). The same procedure would show a tax yield of \$2.7 million for county governments and \$2.8 million for school districts directly attributable to the tobacco support program.

Tobacco's Credit Situation

Tobacco is extremely important to the agricultural economy of the South. Most of the twelve southern states produce substantial amounts of tobacco. But the farmers of these southern states are having financial problems already, and an increase in tobacco imports will be an additional threat to their survival. The following figures will illustrate this point. The proportion of southern farmers who had bank financing discontinued is higher than that of any other region of the country, more than double the national average: 6.4 percent in the South and 3.1 percent for the rest of the nation. The proportion of farmers who borrowed to their limit is higher in the South than in any other region: 49 percent in the South and 32 percent for the nation, which places the South more than 50 percent above the national average. The proportion of farmers who have gone out of business recently is higher than in any other region of the country: 3.9 percent for the South and 2 percent for the nation, the South nearly doubling the national average. Finally, the proportion of farmers who recently went bankrupt is 1.6 percent in the South and 0.6 percent for the nation, giving the state more than double the national average.

Despite this, the Kentucky farm economy has experienced less of the farm credit crisis than have many of our fellow agricultural states. That this has been the case is explainable primarily, if not solely, by the presence of the tobacco industry. Even in its present dire condition tobacco can be counted on to provide a cash flow for thousands of Kentucky farmers who would otherwise be unable to meet their financial obligations. This circumstance is due to tobacco's relatively low capital costs and its high labor-intensity. Were it not for this relatively stable source of income, Kentucky's farm problems, as bad as they are, would be much worse and would quickly spill over into the farm credit industry.

Elimination of the tobacco support program would have an immediate and devastating effect on the tobacco farmer's credit. That program creates an income stream to the owner of the tobacco allotment in the form of the annual lease value of that allotment. The lease value is then capitalized into the value of the land containing the allotment. Eliminating the program would immediately destroy that value of the tobacco land which is attributable to the income stream from the quota.

Quota lease rates in Kentucky vary from 30¢ to 70¢ per pound, with 50¢ being a reasonable average. If buyers and sellers of farm land expect the income from the quota to continue for 10 years and they expect the interest rate after inflation over that period to be 10 percent, then the quota would be worth a little over $3 per pound. On 1984's crop of 499 million pounds this would mean a value of $1.5 billion for our state's quota system, which is directly reflected in the value of our farm real estate. Elimination of the program would result in the instant loss of that amount of asset value to Kentucky landowners. Farmers who are now reasonably well-off would find themselves suddenly in debt beyond their net worth, as a large portion of their land asset vanished. Loans would have to be called and bankruptcies would soon follow. Farm banks in tobacco-growing regions could well find themselves unable to survive.

III. IMPLICATIONS FOR THE FUTURE

The 1985 Crop

The Kentucky Department of Agriculture's survey of farmers' intention indicates the number of acres planted this year will fall to 175,000 from last year's 210,000 acres. Assuming that yields per acre this year are similar to those of last year's relatively good crop, the decrease in acreage planted will result in a 17% smaller crop. This means that 415,625,000 pounds will be produced; down 83,125,000 pounds from last year's 498,750,000.

In 1984 the average price received per pound was $1.88. Of this $1.88, $1.085 per pound is accounted for by total direct income accruing to farmers and farm workers, leaving $.79 for non-labor expenses, such as plant bed expenses, fertilizer, chemicals, fuel, interest on operating funds, property tax, and marketing fees. Assuming price remains constant at $1.88, direct income losses attributable solely to the smaller crop will be $90,190,625, a 16.7% reduction.

Unfortunately, this is not all of the story. Non-labor costs are likely to increase and it is assumed they will increase at the rate of inflation (4%) to 83¢ per pound. Further, the Kentucky Department of Agriculture estimates the no-net-cost fee will increase by 21¢ to a total of 30¢ per pound. These two effects raise the non-labor portion of costs to $1.04 per pound, leaving 84¢ for total direct income - a substantial decrease from 1984's 1.085 per pound.

Overall total direct income will amount to $349,125,000 in 1985; roughly a 35% decline from 1984. Approximately 45% of this decline is attributable to the smaller crop size, while the remaining 55% is attributable to a slightly lower real average price, and a significant increase in the no-net-cost fee. Furthermore, through the income multiplier effect an additional income loss of $495,000,000 will be felt throughout the Kentucky economy, making total income from tobacco production in Kentucky fall some $687,000,000.

Direct employment will fall proportionately with the crop size. 1985 will see a loss of around 5100 direct full-time jobs provided by tobacco. In addition, a loss of around tobacco support industries employment and other indirect employment effects will account for another 4,000 job decline. This is manifest through the tobacco employment multiplier estimated to equal 1.76. Total employment from tobacco will decline roughly 9,100, from 54,521 in 1984 to 45,500 in 1985.

Total sales from the 1985 crop will be $781,375,000; with a tobacco output multiplier of 2.54, total Kentucky output from tobacco production will be $1,985,000,000; down $400,051,000 from 1984.

As discussed previously, land values in Kentucky reflect tobacco's high value per acre. Decreases in tobacco generated real income decrease the value of tobacco plot holdings. Direct income loss will be allocated between farmers and farm workers in accordance with their respective bargaining positions in the labor market. Because of the superior bargaining position enjoyed by farmers, it is assumed that 2/3 of the direct income loss will be absorbed by laborers, with the remaining 1/3 being absorbed by growers. Under this set of assumptions farmers' net income per pound falls to 42¢, determined as follows:

Total Direct Income Loss Per Pound = \$1.085 - \$.85 = \$.235
Farmers' Net Loss Per Pound = \$.235 x .333 = .078 = .08
Farmers' 1984 Net Income Per Pound = \$.50
Farmers' 1985 Net Income Per Pound - \$.50 - \$.08 = \$.42

A 42¢ per pound average income discounted at 10% annually for 10 years has a net present value of \$2.59 per pound. With 1985's poundage of 415,625,000, property values stemming from the price support program total \$1,076,500,000, a reduction of \$423,500,000 or 28%.

Tobacco production will generate income of \$1,250,000,000, at an average effective income tax rate of 2.75%. This represents an income tax yield of \$31,250,000.

Sales tax receipts are a function of the value of products sold in the economy. Tobacco production will account for \$1,985,000,000 of total output. Kentucky's effective output-to-sale tax ratio has been found to be .00816. Thus \$16,195,000 of sales tax receipts will be derived from tobacco production.

In addition to the income tax and sales tax, many other state tax receipts are closely tied to fluctuations in residents' income. In 1984, tobacco production approximately 53,400,000 of these other income related revenues. Under the assumptions used here, Kentucky's total tobacco income declined by roughly 35%. Likewise, other income related revenues would be expected to decline proportionately, so these tax receipts would be reduced by \$18,690,000, reducing other income related tax receipts to \$34,800,000 from \$53,400,000.

In this senario total state revenues would total to $104,173,000 , a decline of 17% from 1984. A table detailing the 1985 crop projection is at the end of this section.

Potential Fiscal Costs From a Loss of Tobacco Income

The loss of tobacco as a source of income would cause the total income of many Kentuckians to fall to levels that would entitle them to receive benefits from public low-income assistance programs. These programs are already very costly and such a loss would add considerably to those costs. When a family's income falls below the Poverty Index they become eligible for food stamp benefits. The current Poverty Index for a family of four is $10,650. Food stamp benefits for a family of four are $138 a month.

The average tobacco income for the 30,98[illegible] full-time equivalent Kentucky tobacco farmers, was $14,670. It would only take a loss of four thousand dollars to push this average income to below the family-of-four poverty level. Some of these farmers and their families have sufficient income from other sources to keep them off public assistance. Others, even with their tobacco income, already receive some form of assistance. If the loss of tobacco income causes one-half of the current tobacco farmers (15,500) to go on food stamps, the cost to the public would be $2,132,000 a month, or $25.6 million a year. Food stamps are federally funded, so the costs would be borne by the federal taxpayer.

In addition, those families who would otherwise qualify for Social

Security Insurance (SSI) or Aid to Families with Dependent Children (AFDC), but whose tobacco income allowed them to be self-supporting, would be entitled if they lost that income, to receive such support. Over 16 percent of Kentucky tobacco farmers are 65 years old or older. They are thus eligible for an average of $305 per month in Medicaid Funds. For female tobacco farmers (over 6 percent of Kentucky tobacco farmers are female) with children, a drop in incone to below the poverty level would entitle them to an average of $197 per family in Aid to Families with Dependent Children assistance. The costs of both of these latter programs is currently 70 percent federal, 30 percent state, but will go to 65 percent federal, 35 percent state, in October of this year.

If half of those over 65 become eligible for Medicaid because of a loss of tobacco income, that would be 2,500 new recipients (at $305 a month). Their total costs would be $763,000 a month, or $9.1 million annually. Similarly, if half the female tobacco farmers become eligible for AFDC benefits, that could mean 1,860 new recipients of $197 per month, or $4.4 million a year. These direct costs would mean $39.1 million in added public assistance costs. Thirty-five million dollars to the federal taxpayer and $4.1 million new cost to the state.

Since loss of tobacco income would, in turn, cause a loss in income to other members of the community, costs to the public sector would also have to include providing for these indirect losses. Using the employment multiplier to estimate the total number of people becoming eligible for benefits it is found that the total new food stamp recipients would be 27,280. It would cost $3.8 million a month or $45.2 million a year to provide food stamps to that number of people.

Applying the multiplier to the number of direct new Medicaid recipients would show 4,400 total recipients for a cost of $1,342,000 a month or $16,104,000. The state's share of that annual figure would be $4.8 million.

For AFDC recipients, the 1,860 people directly pushed on to public assistance would cause a total of 3,275 people to be placed on the roles of that program. That would cost $645 thousand a month in benefit payments, or $7.7 million a year. The state would have to provide $2.3 million of that cost.

Budgetary Implication of a Loss of Tobacco Revenue

The Fiscal Year 1985 Kentucky General Fund Budget is $2.5 billion. The total tax revenue from tobacco production is $130 million, or the equivalent of 5.2 percent of the General Fund. A loss of revenue from tobacco growing would necessitate either a further cutback in state services or a tax increase. Kentucky is currently 10th highest in the nation in state taxes per $1000 of income. In spite of this, because of our low total income, we generate a relatively small amount of revenue to provide services for our citizens. As we all know, tax increases are a painful subject. But we should consider what a loss of $130 million would mean to our 1985 General Fund Budget.

Eighty-five percent of the General Fund Budget goes for basic services - Education/Humanities, Higher Education, Human Resources, and Justice and Corrections. An additional 8 percent goes for what is called "basic maintenance" - the Courts, the Legislature, Revenue and Finance. Only 7 percent, or $200 million is left for what are generally termed "discretionary funds" - Commerce, Development, Energy, Labor, Pubic Protection, Natural Resources and Tourism.

If cuts are confined to the "discretionary" category, a $130 million loss would require a 65 percent reduction in funding for these programs.

If even the "basic" activities are subject to cuts, and only education (Education/Humanities and Higher Education) is exempted, a $130 million loss would require a 15 percent cutback in all other activities.

Kentucky's ability to sustain such cutbacks is highly doubtful. A substantial tax increase, on top of an already high tax burden, would almost certainly be required to support the state government at any reasonable level. Ironically, this increase would occur just at the time when a large portion of the citizenry would lose its ability to pay taxes because of the loss of their tobacco income.

SUMMARY SHEET OF 1985 PROJECTIONS

	1984	1985(Pr=1.88)	% Change from 1984
Total Acreage	210,000	175,000	17%
Pounds Produced	498,750,000	415,625,000	17%
Direct Income	541,000,000	349,000,000	35%
Total Income	1,937,013,000	1,265,000,000	35%
Farmer Net Income/Pound	50¢	42¢	
Laborers Income/Pound	58.5¢	44¢	
Direct Employment	30,978	25,800	17%
Total Employment	54,521	45,400	
Total Sales	938,996,630	781,375,000	17%
Total Tobacco Production	2,385,051,000	1,985,000,000	17%
Property Values	1,500,000,000	1,076,500,000	
Direct Income Tax Receipts	53,268,000	34,781,000	34%
Sales Tax Receipts	19,462,000	16,195,000	17%
Other Income Related Tax Receipts	53,400,000	34,800,000	35%
Total Tax Receipts	126,130,000	104,173,000	17.4%

United States Department of Agriculture

Agricultural Stabilization and Conservation Service

P.O. Box 2415
Washington, D.C.
20013

Honorable Pete Worthington
Office of The Speaker Pro-Tempore
Kentucky House of Representatives
Frankfort, Kentucky 40601

SEP 09 1985

Dear Mr. Worthington:

Thank you for your letter concerning the assumptions used to determine the "No Net Cost Assessments" for the 1982-85 burley crop years.

The Secretary is required by the No Net Cost Tobacco Program Act of 1982 to determine the assessment and adjust the amount from time to time in consultation with the associations. The 1985 burley producer marketing assessment of 30 cents per pound was established to cover projected losses on the 1983, 1984, and 1985 crops. All calculations were based on the burley loan status as of January 30, 1985.

The assumptions used are as follows:

1. 1985 price support level — \$1.788 per pound. Association loan receipts - \$1.80 per pound.

2. Average selling price per pound: 1982 crop, \$3.48; 1983 crop, \$2.24; 1984 crop, \$2.90; and 1985 crop, \$2.97.

3. Transportation and processing cost per pound \$.28 (dry weight).

4. Storage/overhead cost = .3 percent per year on the loan principal outstanding.

5. From January 30, 1985 - four years to liquidate the 1982 crop, six and one-half years to sell the 1983 crop (with no sales until 1986), and five years to liquidate each of the 1984 and 1985 pool stocks.

6. Average interest rate — 11 percent per year on loans. Average interest on No Net Cost Accounts = 10.45 percent per year.

7. Also enclosed is an estimate of the assessment required to recover outstanding interest plus one years interest and carrying charges if no sales of loan stocks are made.

Again, thank you for writing.

Sincerely,

Assistant
Deputy Administrator, Thomas A. VonGarlem
State and County Operations

Enclosure

SEP 0 9 1985

Type-31
11% Interest Rate

Crop	Principal	Interest
	($1,000)	
1982	222,545	52,269
Less Sales	-4,860	-1,140
Total 1982	217,685	51,129
1983	497,977	53,919
1984	376,153	4,138
Total	1,091,815	109,186
1 Year Interest And CC @ 11.3%	3,275	120,100
	1,095,090	229,286
Recover 1 Year Interest And CC		123,375
1/2 Accumulated Interest		54,593
		177,968
Less NNC Accounts		-97,030
		80,938

80,938 Div. By 525,000 = 15.42¢ Per Pound Assessment

Recover Outstanding
Interest + 1986? Interest And CC

	232,561
Less Accounts	-97,030
	135,531

135,531 Div. By 525,000 = 25.82¢ Per Pound Assessment

Recover Outstanding
Interest + 1986 Interest
And CC. Without The Use Of 1982, 1983 And 1984
NNC Accounts.

232,561 Div. By 525,000 = 44.3¢ Per Pound

1984 CROP BURLEY

YEAR	POUNDS	PRINCIPAL	INTEREST	TOTAL	Cost/Sales $Per lb.
1985	166.5	408.3	36.7	445.0	2.67
(SALE)	(33.3)	(85.3)	(7.9)	(93.2)	2.80
	133.2	323.0	28.8	351.8	2.64
1986	133.2	323.9	64.3	388.2	2.91
SALE	(33.3)	(87.9)	(10.3)	(98.2)	2.95
	99.9	236.0	54.0	290.0	2.90
1987	99.9	236.7	79.9	316.6	3.17
SALE	33.3	(74.9)	(25.0)	(99.9)	3.00
	66.6	161.8	54.9	216.7	3.25
1988	66.6	162.3	72.7	235.00	3.52
SALE	(33.3)	(78.2)	(35.0)	(113.2)	3.40
	33.3	84.1	37.7	121.8	3.66
1989	33.3	84.4	46.9	131.3	3.94
	(33.3)	(51.0)	(28.3)	(79.3)	2.38
		33.4	18.6	52.0	

$52 Loss

$377.3 - Principal Paid
$106.5 - Interest Paid
483.8 - TOTAL REPAYMENT

$2.90 Per Pound Average Selling Price

1983 CROP BURLEY

YEAR	POUNDS	PRINCIPAL	INTEREST	TOTAL	Cost/Sales $Per lb.
		—millions—			
1985	214.1	498.0	53.9	551.9	2.58
		493.5	108.7	602.2	2.81
1986					
SALE	(35.7)	(66.9)	(14.7)	(81.6)	2.28
	178.4	426.6	94.0	550.6	3.09
1987		427.9	140.9	568.8	3.19
SALE	(35.7)	(61.0)	(20.6)	(81.6)	2.28
	142.7	366.9	120.3	497.2	3.48
1988	142.7	368.0	160.7	528.7	3.70
	107.0	311.2	135.9	447.1	4.18
SALE	(35.7)	(56.8)	(24.8)	(81.6)	2.28
1989		312.1	170.1	482.2	6.51
SALE	(35.7)	(52.8)	(28.8)	81.6	2.28
	71.3	259.3	141.3	400.6	5.61
		260.1	169.8	429.9	6.03
1990					
SALE	(71.3)	(93.3)	(59.7)	(153.0)	2.146
	0	166.8	110.1	276.9	

$276.9 Loss
$330.8 Principal Paid
$149.6 Interesc Paid
$2.24 Per Pound Average Selling Price

SCHEDULE D

ESTIMATED GROWER ASSESSMENT
BURLEY TOBACCO

Year Beginning October 1

		1982	1983	1984	1985
(A)	Loan Receipts Green Weight (in thousand lbs.)	269,241	255,200	200,000 [1]	150,000 [1]
(B)	Sales - Dry Weight (in thousand lbs.)	102,705	-0-	-0-	-0-
(C)	Uncommitted Stocks - Dry Weight (in thousand lbs.)	96,625	214,056	166,520	124,890
(D)	Estimated Gain/(Loss) - Dry Weight (Cents per Pound)	-0-	(129.3)	(31.2)	(42.0)
(E)	Estimated Gain/(Loss) (in thousands)	-0-	($ 276,855)	($ 52,000)	($ 52,500)
(F)	Assessment Fee (Cents per Pound)	1¢	5¢	9¢	30¢
(G)	Marketings (in thousand lbs.)	776,273	524,200	690,000	525,000
(H)	No Net Cost Account (in thousands)	$ 7,763	$ 26,210	$ 62,100	$ 157,500
(I)	Interest Factor	1.62	1.67	1.48	1.48
(J)	Account Adjusted for Interest (in thousands)	$ 12,576	$ 43,771	$ 91,908	$ 233,100
(K)	Gain/(Loss) [2] (in thousands)	$ 12,576	($ 233,084)	$ 39,908	$ 180,600

FORMULAE

1. C X D = E.
2. F X G = H.
3. H ÷ I = J.
4. J - E = K.

FOOTNOTES

1. Estimated.

2. Gain on 1982, 1984, and 1985 crop operations will offset 1983 crop lossess and the account should reflect a -0- balance after the crops are sold.

SOURCE: United States Department of Agriculture.

Doc. 940M

SCHEDULE A

BURLEY TOBACCO GROWERS COOPERATIVE ASSOCIATION

Summary of Income and Expenses

For Fiscal Years Ending September 30

INCOME	1980	1981	1982	1983	1984
Interest*	$ 245,501	$ 418,510	$ 645,763	$ 535,447	$ 483,460
Rents	22,496	23,128	23,124	23,173	29,220
Proceeds from 1974 Crop Year	27,037	-0-	-0-	-0-	-0-
Proceeds from 1975 Crop Year	-0-	533,907	-0-	-0-	-0-
Proceeds from 1976 Crop Year	-0-	416,664	-0-	-0-	-0-
Proceeds from 1977 Crop Year	-0-	-0-	537,262	-0-	-0-
Proceeds from 1978 Crop Year	-0-	-0-	980,357	-0-	-0-
Proceeds from 1979 Crop Year	-0-	-0-	132,058	-0-	-0-
Unredeemed checks	-0-	-0-	463,569	869,884	-0-
Carryover tobacco	-0-	-0-	-0-	-0-	178,182
Other	6,836	67,658	-0-	-0-	-0-
Total	$ 301,870	$ 1,459,867	$ 2,782,133	$ 1,429,504	$ 690,862

EXPENSES	1980	1981	1982	1983	1984
1980 crop year loss	-0-	33,448	-0-	-0-	-0-
Salaries	37,729	33,759	[illegible]	27,682	31,061
Directors' expense	12,669	11,604	11,219	15,367	12,650
Depreciation	11,156	12,403	10,330	12,144	22,532 *
Pension plan contribution	6,254	5,650	311	1,002	2,490
Insurance	11,041	12,595	12,504	16,124	12,726
Repairs and maintenance	13,391	14,852	22,038	12,769	13,355
Utilities	6,049	7,501	10,742	12,008	13,444
Payroll taxes	5,173	5,110	2,396	2,231	3,208
Professional services	19,742	20,000	18,780	24,850	21,100
General taxes	3,204	3,102	3,075	5,646	2,919
Miscellaneous	5,417	6,584	6,722	6,039	10,405
Janitor expense	959	1,735	1,974	1,543	1,476
Dues and subscriptions	436	1,457	703	1,010	569
Advertising and promotion	217	1,586	525	1,317	1,243
Travel	3,801	5,095	8,433	7,857	7,978
Total	$ 134,048	$ 178,384	$ 140,128	$ 148,489	$ 158,356
Income before Federal taxes:	$ 167,822	$ 1,281,283	$ 2,642,005	$ 1,281,015	$ 532,506
Currently payable Federal income taxes:	(97,046)	(670,523)	(1,336,760)	(603,035)	(240,798)
Excess of income over expenses:	$ 70,776	$ 610,760	$ 1,305,245	$ 677,980	$ 291,708
Rate of inflation:	13.5 %	10.4 %	6.1 %	3.2 %	4.2 %

* Increase in depreciation due to purchase of an IBM-36 Computer.

SOURCE OF INFORMATION: Burley Tobacco Growers Cooperative Association.

SCHEDULE B

BURLEY TOBACCO GROWERS COOPERATIVE ASSOCIATION

Stock Profile

(figures in pounds)

	FISCAL YEARS ENDING SEPTEMBER 30				
	1980	1981	1982	1983	1984
Stocks at Beginning of Year	93,580,814	25,442,912	-0-	511,146	169,767,659
Stocks Added	5,528,539	18,879	520,999	170,371,864	181,939,751
Stocks Sold	(73,666,441)	(25,461,791)	(9,853)	(1,115,351)	(103,062,849)
Stocks Held at End of Year	25,442,912	-0-	511,146	169,767,659	248,644,561

918M

SCHEDULE C

BURLEY TOBACCO GROWERS COOPERATIVE ASSOCIATION

Summary of Operating Statements
1982-84 Crops

	1982 Crop	1983 Crop	1984 Crop
ADVANCE TO MEMBERS	$ 389,090,956	$ 379,867,779	$ 301,295,810
HANDLING			
Redrying	$ 34,494,152	$ 36,202,706	$ 24,549,546
Green Prizing	1,852,248	945,150	96,304
Transportation	2,400,894	2,916,186	1,944,902
Storage	1,830,475	1,488,016	254,552
Innage	355,145	373,487	277,916
Outage	177,135	55	-0-
Sampling	8,363	4,634	-0-
Weighing	-0-	30	-0-
Insurance - Tobacco	261,579	276,683	90,124
Grading at Redryer	400,003	391,674	262,342
Subtotal (Handling)	$ 41,779,994	$ 42,598,622	$ 27,475,685
OVERHEAD			
Overhead Fees	-0-	-0-	$ 5,780
Officers Fees	13,570	6,750	-0-
Officers Salaries	96,902	57,209	45,898
Accounting Salaries	228,090	132,540	101,498
Supervisors Salaries - Field	21,064	14,678	14,672
Supervisors Salaries - Sales	64,241	36,695	29,426
Officers Travel Expense	2,079	1,025	950
Supervisors Travel Expense - Field	14,083	11,420	11,770
Supervisors Travel Expense - Sales	5,718	2,252	1,064
Directors Fees	8,687	4,746	2,718
Directors Travel Expense	12,110	6,178	3,213
Rent	21,385	12,390	9,525
Postage	65,040	35,485	5,119
Express	778	290	262
Stationery & Printing	58,587	51,401	20,841
Machine Rental	27,106	15,268	21,011
Telephone & Telegraph	13,205	6,717	4,275
Employees Hospital Insurance	19,856	17,450	10,659
Workmens Compensation Insurance	824	572	151
Employees Life Insurance	2,825	2,910	-0-
Employees Security Plan	35,072	24,028	3,277
Taxes - FICA	27,736	16,461	13,498
Taxes - Unemployment	4,124	4,202	1,825
State Taxes on Tobacco in Storage	4,275	-0-	-0-
Auditing Fees	5,044	1,059	-0-
Automobile Expense	3,287	2,478	1,905
Legal Fees	100	500	6,727
Data Processing	95,924	55,035	9,067
Quality Control	-0-	-0-	7,053
Miscellaneous	-0-	3,240	136
Subtotal (Overhead)	$ [illegible]	$ 523,377	$ 332,319
Accrued Interest	$ 68,586,496	$ 54,764,066	$ 10,387,909
Citizens Union National Bank - Operating Account	1,021,466	(519,020)	(332,224)
First Security National Bank - Sales Account	-0-	-0-	5,597
Accounts Receivable	1,445,812	6,998	-0-
GRAND TOTAL	$ 502,778,260	$ 477,241,522	$ 339,165,096
Loan Repayments - Nest Penalty	$ 11,807	-0-	-0-
Sales	$ 310,620,663	$ 102,274	$ 5,597
Accrued Interest Payable	$ 38,336,509	$ 54,728,526	$ 10,382,125
First Security National Bank - Loan Account	153,809,281	422,410,722	328,777,374
GRAND TOTAL	$ 502,778,260	$ 477,241,522	$ 339,165,096

NOTE: Figures are approximate due to rounding.

ADDENDUM TO SCHEDULE C

Schedule of Pounds Purchased, Redried and Sold Per Crop Year

	1982	1983	1984
Pounds purchased:	209,221,237	216,294,605	159,575,718
Pounds redried:	169,416,678	181,920,395	133,142,455
Pounds sold:			
Redried	107,015,450	31,539	-0-
Green	955,286	25,713	5,025
Total Pounds Sold:	107,970,736	57,272	5,025

938M

SCHEDULE D

ESTIMATED GROWER ASSESSMENT
BURLEY TOBACCO

Year Beginning October 1

		1982	1983	1984	1985
(A)	Loan Receipts Green Weight (in thousand lbs.)	269,241	255,200	200,000 [1]	150,000 [1]
(B)	Sales - Dry Weight (in thousand lbs.)	102,705	-0-	-0-	-0-
(C)	Uncommitted Stocks - Dry Weight (in thousand lbs.)	96,625	214,056	166,520	124,890
(D)	Estimated Gain/(Loss) - Dry Weight (Cents per Pound)	-0-	(129.3)	(31.2)	(42.0)
(E)	Estimated Gain/(Loss) (in thousands)	-0-	($ 276,055)	($ 52,000)	($ 52,500)
(F)	Assessment Fee (Cents per Pound)	1¢	5¢	9¢	30¢
(G)	Marketings (in thousand lbs.)	776,275	524,210	690,000	525,000
(H)	No Net Cost Account (in thousands)	$ 7,763	$ 26,210	$ 62,100	$ 157,500
(I)	Interest Factor	1.62	1.64	1.48	1.48
(J)	Account Adjusted for Interest (in thousands)	$ 12,576	$ 42,971	$ 91,908	$ 233,100
(K)	Gain/(Loss) [2] (in thousands)	$ 12,576	($ 233,084)	$ 39,908	$ 180,600

FORMULAE

1. C X D = E.
2. F X G = H.
3. H x I = J.
4. J - E = K.

FOOTNOTES

1. Estimated.

2. Gain on 1982, 1984, and 1985 crop operations will offset 1983 crop losses and the account should reflect a -0- balance after the crops are sold.

SOURCE: United States Department of Agriculture.

Doc. 940M

APPENDIX 6

TESTIMONY

OF THE

KENTUCKY LEGISLATIVE TOBACCO TASK FORCE

BEFORE THE

U.S. INTERNATIONAL TRADE COMMISSION

January 3, 1985

Madame Chairman and Commissioners, it is a distinct pleasure and opportunity for the members of the Kentucky Legislative Tobacco Task Force to testify before you today. We thank you very much.

Kentucky Legislative Tobacco Task Force

The Kentucky Legislative Tobacco Task Force was created by the Legislative Research Commission, the administrative agency for the Kentucky General Assembly, out of the recognition of the extremely difficult problems which face the tobacco industry, especially the tobacco farmer. The mission of the Tobacco Task Force is to study the effect of tobacco imports on Kentucky tobacco, the no net cost program, and other issues related to the tobacco price support program.

The Tobacco Task Force is made up of five state senators and five state representatives. These 10 legislators have a total of about 170 years of experience in tobacco production, auctioning tobacco, and financing tobacco farmers.

The task force has held six meetings, including three public hearings. Through the process of public hearings, meetings, and research, the task force is determined to conduct a comprehensive review of the various aspects of the tobacco price support program and their effect on Kentucky tobacco farmers and the state's economy. Then the task force intends to assist in the development of legislation affecting tobacco in the 1985 Congress.

Why Tobacco Imports Should Be Restricted

The Kentucky legislative Tobacco Task Force believes that the President should take the immediate necessary legal action under Section 22 of the Agricultural Adjustment Act (7 USCA Section 624), as amended, to reduce tobacco imports because these imports "... render or tend to render ineffective, or materially interfere with ..." the tobacco price support program. The remainder of this testimony will attempt to substantiate this belief.

While the U.S. share of unmanufactured burley exports has been decreasing in comparison to total world trade, burley tobacco imports have been increasing. The share of U.S. unmanufactured burley exports in comparison to the world total exports was about 60 percent in 1960 and dropped to about 25 percent in 1982. Meanwhile, the share of imported burley tobacco of the total U.S. disappearance of burley increased from less than one percent in 1970 to almost 25 percent in 1983.

In short, imports of burley tobacco have increased almost 290 percent since 1975.

U. S. burley is produced under the price support program. To receive the benefit of a price support, production of tobacco must be controlled. The burley producer took a 10 percent cut in production quota in the 1984 crop and in all probability will take at least another 10 percent cut in the 1985 crop. This is patently unfair to the American burley tobacco farmer since producers in foreign countries have no production controls. The absence of production control on the foreign producer has created a tobacco glut in the world market, resulting in increased imports to the U.S. and decreased exports of American tobacco.

Imported tobacco continues to contribute to the high cost of operating the No Net Cost Tobacco Act. Burley tobacco farmers' costs of funding the no net cost program continue to increase each year, as an average of about [illegible] percent of the 1982, 83, and 84 crops, through December 13, 1984, went into the burley pool. None of the [illegible] burley crop went to the pool. But there are about [illegible] pounds of the 1982 and 1983 burley crops in the pool as of January 1, 1985. This large amount of burley tobacco in the pool has caused the no net cost assessment to increase from one cent a pound in 1982 to nine cents a pound in 1984. With about [illegible] pounds of green burley from the 1984 crop going to the pool as of January 1, 1985, the no net cost assessment is expected to go as high as [illegible] cents a pound in 1985. The prospects are dim when considering the increasing cost to the farmer of funding the No Net Cost Tobacco Act. Each pound of imported burley or flue-cured tobacco contributes toward the higher cost of funding the no net cost program -- at the expense of the American tobacco farmer.

American tobacco producers are at an extreme disadvantage in competing with foreign producers. U.S. burley tobacco laborers are paid six to eight dollars per hour when cutting and housing tobacco, as compared with only a few dollars a day for laborers in many countries. In addition, subsidies are given by the governments or manufacturing companies in some foreign countries importing tobacco into the United States. For instance, the Republic of Korea, a large importer of tobacco into the United States, pays 21 percent of the cost of fertilizers used to produce tobacco and gives free tobacco seed to the producers. In Brazil, the largest importer into the United States, American companies provide free seed and fertilizer, and pay for transporting the tobacco crop to market.

Tobacco In The South

Tobacco is extremely important to the agricultural economy of the South. Of the twelve southern states, most produce substantial amounts of tobacco. But the farmers of these southern states are having financial problems, and an increase in tobacco imports will further worsen their financial condition. To illustrate this point the following is offered. The proportion of southern farmers who had bank financing discontinued is higher than in any other region of the country: 6.4 percent in the South and 3.1 percent for the rest of the nation, which is more than double the national average. The proportion of farmers who borrowed to their limit is higher than in any other region: 49 percent in the South and 32 percent for the nation, which is more than 50 percent above the national average. The proportion of farmers who have gone out of business recently is higher than in any other region of the country: 3.9 percent for the south and 2 percent for the nation, which is double the national average. Finally, the proportion of farmers who recently went bankrupt is 1.6 percent in the South and 0.6 percent for the nation, which is more than double the national average.

Kentucky Tobacco Producers

Any factor which harms the tobacco price support program, such as imports, will have an adverse and possibly disastrous effect on Kentucky tobacco farmers. Almost 72 percent of Kentucky's tobacco farmers depend on tobacco for at least 50 percent of their gross farm sales. About 76 percent of Kentucky's tobacco farmers have a net annual farm income of less than $10,000. About 47 percent of Kentucky tobacco farmers have an annual total family income of less than $20,000. About 61 percent of Kentucky tobacco farmers are 46 years of age or older, about 83 percent grew up on the farm, and about 44 percent have less than a high school education, indicating that the Kentucky tobacco farmer is strongly attached to farming and a change in vocation brought about by the demise of the tobacco price support program would be extremely difficult for him.

Economic Impact of Tobacco on Kentucky

In 1981, the total full-time equivalent employment of tobacco production workers in Kentucky was 30,987. These are farmers and hired workers engaged in tobacco production. Tobacco production accounted for 2.3 percent of Kentucky's total employment.

The total value of tobacco production in Kentucky in 1981 was $912,721,000. The production of tobacco accounted for 1.1 percent of the total value of all of the goods and services produced in Kentucky.

In 1981, Kentucky farmers and farm workers received an estimated net income from tobacco of $97,485,000. This amounts to 39 percent of the total income from crops grown in Kentucky, and 28 percent of the total net income from farming.

To evaluate the economic impact of the tobacco industry on the state it is necessary to consider the effect that tobacco has on other industries, as well as the direct effect of the industry itself. A 1983 study conducted at the University of Kentucky estimated tobacco's indirect impact (impacts on industries that supply the tobacco industry with products or materials) and its induced impacts (those that result as tobacco income is re-spent in the state's economy) for 1981. From this extensive analysis of the Kentucky economy it was found that the total employment (direct and indirect) in 1981 attributable to tobacco production was 54,537. This was 4.1 percent of Kentucky's total employment.

The value of output in the state attributable to tobacco production in 1981, both directly and through secondary effects, was found to be $2,318,311,000. This was 2.9 percent of the total value of the gross state product of Kentucky.

In terms of income, the total income generated in the state in 1981 that was traceable directly or indirectly back to the production of tobacco was $372,393,000. This was 1.5 percent of the total income of Kentucky's citizens.

Thus, from this analysis, a loss of one percent in Kentucky's tobacco output would result in 545 jobs being lost to a hard-pressed sector of the state's economy.

A one percent decrease in tobacco output would result in a $23,318,000 decrease in total state product.

Finally, a one percent decrease would correspond to $3,724,000 in lost income to the citizens of the state.

Given that a large portion of tobacco farmers and workers are older, have relatively low education, and have few skills in other areas of employment, any decrease would harm an already depressed and vulnerable sector of the state's economy.

Tobacco is by far Kentucky's largest cash crop, accounting for more than 50 percent of the total crop receipts of Kentucky farmers.

Tobacco production accounts for over 12 percent of the employment in 10 of Kentucky's counties. These counties are among the poorest in the state. They include the two poorest counties in the state, and all of these counties earn less than the average income in Kentucky, which is the 5th lowest in the naton. At the same time, these counties have high unemployment rates, averaging over 14.6 percent unemployment.

Recommendations

Therefore, the Kentucky legislative Tobacco Task Force recommends that the President take the immediate necessary legal action under Section 22 of the Agricultural Adjustment Act (7 USCA Section 624), as amended, to reduce tobacco imports because they "... render or tend to render ineffective, or materially interfere with ..." the tobacco price support program. It is recommended that tobacco imports be reduced to expeditiously bring the excessive tobacco loan stocks in the pool under control. Fifty million pounds of tobacco carryover in the pool is the maximum level objective.

The reasons, as previously stated, for this recommendation are:

- Imports of burley tobacco have increased about 290 percent since 1975.

- Imports of tobacco unnecessarily increase the cost of the no net cost program, at the expense of the American tobacco farmer.

- American tobacco farmers have production controls while foreign producers do not, an unfair advantage for the foreign producer.

- Tobacco is the lifeblood of Kentucky agriculture, accounting for about 50 percent of the state's total crop receipts.

- About 76 percent of Kentucky's tobacco farmers have a net annual farm income of less than $10,000.

- Imports of burley tobacco have contributed to the increase of burley pool tobacco from zero pounds in 1981 to about 307,000,000 pounds as of January 1, 1985, not including the large amount of the 1984 burley crop going to the pool.

Furthermore, the Kentucky legislative Tobacco Task Force makes these additional recommendations on tobacco imports to the President.

The United States should not allow tobacco imports from those countries which do not allow American tobacco into their countries.

The United States should not allow tobacco imports from those countries which subsidize the production or manufacturing of tobacco.

The United States should not allow imported tobacco which does not meet the same pesticide and herbicide requirements which American-produced tobacco must meet.

Imported tobacco should be charged a single rate of duty for each pound, regardless of the classification.

Imported tobacco should not be allowed from nations whose human rights posture precludes a fair wage for a person's effort.

Imported tobacco should not be allowed from nations who do not allow a fair and just market for American products.

Imported tobacco should not be allowed from nations which do not require adequate labeling information regarding the use of pesticides and herbicides because of the risk to uninformed workers when exposed to harmful chemicals.

Conclusion

Tobacco is at the heart of Kentucky agriculture, accounting for more than one-half of the total value of all crops grown in the state. Imported tobacco reducing the effectiveness of the tobacco price support program is a serious matter to the Kentucky farmers' wellbeing. Tobacco is a highly labor-intensive crop and is a very physically demanding crop to grow. Tobacco farmers have large capital investments in equipment and land. Tobacco is a billion dollar cash crop in Kentucky. No legal crop can replace tobacco for value per acre, and the average acreage for each burley farmer in the burley-producing states is only from 1 to 3 acres.

A Kentucky burley farmer, speaking at one of the public hearings which our Tobacco Task Force recently conducted, very succinctly expressed the importance of tobacco to Kentucky when he said: "If tobacco is taken away from the small farmer or from this area, there is no one farmer I know who could show a profit in his farming operation. We are talking about the quality of life in rural Kentucky."

Madame Chairman and Commissioners, this concludes our testimony.

Appendix 7

Summary of Comments Made at the Five Public Hearings on Tobacco Held November 26, December 3, December 17, 1984, January 28, March 25, May 30, and October 29, 1985

PRODUCERS

- American dealers are actively supporting the growth of foreign tobacco.

- Tobacco manufacturers raised the prices of their cigarettes 25 to 30 percent in 1982 and 15 to 16 percent in 1983, an increase over and above the increase in the excise tax.

- The U.S. Secretary of Agriculture should be granted authority to adjust allotments by more than 10 percent to bring production in line with disappearance, after consultation with farm leadership.

- Where foreign subsidy exists or where domestic companies or dealers contract, grow or cause burley to be grown in a foreign country an import quota should be established.

- Imports should be limited to 10 percent of U.S. burley disappearance.

- Farmers feel that 50 million pounds is adequate carryover and will assume obligation for that amount. Losses due to excess supply (that sold at a loss when supply exceeds 50 million pounds) shall be the obligation of buyer companies or the Commodity Credit Corporation.

- Allow marketing of only 100 percent of quota, but give the Secretary of Agriculture the option to allow 110 percent marketing in the event of a short supply.

- If the leasing provisions weaken congressional acceptance of the tobacco price support program, farmers might consider the elimination of leasing and permit sale of allotments within county lines with a 15,000 pound limit per allotment.

- Prohibit burley imports from those countries that do not permit the U.S. to export burley tobacco products into that country.

- If import quotas are proclaimed (10 percent of disappearance) farmers would consider a reduction in price supports as follows: (a) Cap on no-net cost assessment of ten cents; (b) For each one-cent reduction in no-net cost assessment, price support would be reduced two cents; and (c) Limit no-net cost fund to 100 million dollars.

- Due to the drought disaster of 1983, that crop of pool stocks should be removed from the no-net cost obligation as an emergency measure.

- Farmers in general recognized that U.S. burley prices were increasing faster than world prices and have agreed to support price freezes since 1982, resulting in income reduction of approximately 30 cents per pound.

- Eliminate leasing.

- The President could place import restrictions on tobacco under the authority he presently has under Section 22.

- A surtax of one dollar per pound should be placed on imported tobacco.

- No leaf dealer should be allowed to handle pool tobacco if he imports tobacco.

- Tobacco prices should not be frozen.

- Tobacco producers must be allowed to lease tobacco.

- Tobacco companies should be required to contribute to the pool.

- Cut the tobacco quota by five percent.

- Restrict imports to 10 percent of usage.

- Place quotas in the hands of producers who want to grow it.

- Companies should take a more active role along with the Commodity Credit Corporation in financing pool stocks.

- The no-net cost program must be reduced or eliminated.

- Control should be placed on excessive imports of foreign tobacco and foreign-produced tobacco should meet the same quality control as American-produced tobacco.

- The assessment for the no-net-cost program should be added to the average support price of tobacco.

- The federal excise tax on tobacco should be reduced as scheduled under present law.

- No reduction should be made in the current support price of tobacco.

- We all must work together to save the tobacco price support program.

- Producers should learn to grow alternative crops and develop the ability to market these crops.

- If the tobacco price support program is repealed it should be legal to grow marijuana.

- The U.S. tariff has decreased since the 1930's.

- Imported tobacco has been misclassified in order to reduce the amount of tariff imposed.

- Import quotas should be imposed.

- One cent of the federal excise tax on tobacco should be used to pay one-half of the cost of the no-net-cost program and tobacco companies should pay the remaining one-half cost of the no-net-cost program.

- Today is worse than the night rider days.

- Grading of tobacco is not as accurate as it should be.

- The U.S. government would lose revenue if there is no tobacco price support program.

- We should not share our expert tobacco knowledge with foreign producers.

- The multiplier effect of American-produced tobacco is seven dollars and that of foreign tobacco is two dollars, making a difference of five dollars.

- If we lose the tobacco price support program, we will be in poverty.

- The loss of tobacco allotments would reduce property values.

- Tobacco provides part-time income for young people.

- Leasing tobacco quotas provides retirement income for many people.

- Tobacco benefits state and local governments.

- Speaker supports the 2¢ per pack manufacturing tax on cigarettes.

- Loss of program could cause loans to default.

- Tax on equity from the tobacco program is important to Kentucky's schools.

- Unsuccessful attempts to get protection from imports were due to President Reagan's allies on the I.T.C.

- "Reynolds Plan" has gone from poor to worthless; proposed buyout of 1982 crop at 10¢ on the dollar is unacceptable.

- Tobacco companies are trying to break the tobacco program with increased pool stocks.

- Tobacco program has been a good one, but it no longer does what it was intended to do.

- Price controls cannot work if there are no restrictions in other countries.

BURLEY COOP

- Quotas should remain with the land and not be permitted to be sold.

- Leasing quota should continue to be the subject of private negotiations.

- Imported tobacco should be subject to the same rules regarding grading and the use of chemicals as domestic tobacco.

- Grant the Secretary of Agriculture authority to reduce quotas more than 10 percent.

- Grant the Secretary the authority to adjust the 90 percent parity support to a lower rate allowing the support to be more competitive.

- Place a quota on imports.

TOBACCO BOARD OF TRADE

- Establish standards pertaining to the amount of pesticide and herbicide residue on imported tobacco.

- Cut off all imports from countries that do not allow the sale of our tobacco products in their individual nation.

- The support price has been frozen for the last two years. If this continues, negotiate a commitment from the buying companies to purchase a certain amount of the pool stock.

WAREHOUSEMEN

- The lowest price the farmer could receive is $1.55.

- The federal government should assist tobacco producers in solving the problem with the pool.

- Tobacco should be a commodity included in the farm bill to be enacted by Congress in 1985.

- A maximum ten cents per pound should be placed on the assessment under the No-Net-Cost Program.

- Enact local content laws which would require a certain percentage of American grown tobacco in cigarettes.

- "Reynolds Plan" gives too much leverage to tobacco companies, but it is the best growers can get because tobacco companies are monopolies.

- Protectionism is necessary; farmers cannot compete with cheap foreign labor.

LEAF DEALERS

- The policy of cutting production to maintain price supports makes it extremely hard for U.S. tobacco to maintain its share of the world tobacco market.

- The annual reductions in quotas result in increased lease rates, higher production costs, and increased assessments to fund the No-Net-Cost Program.

- Support prices should be lowered in order to make U.S. tobacco more competitive in the world market. Thirty cents per pound reduction would significantly influence U.S. buyers to switch from imports to domestic tobacco.

- Federal assistance to farmers is necessary to relieve farmers of the No-Net-Cost Program.

- An orderly scheme must be devised for moving surplus stocks into world trade without disrupting new crop markets.

- Import restrictions would only cause the loss of exports equivalent to the amount imports are reduced due to retaliation and diversion of imported tobacco into U.S. export markets.

- A support average of about $1.40 would probably move most U.S. production into trade channels.

- There are two very clear choices about price and production: (1) maintain high prices, adopt protectionist policies and supply a decreasing domestic market; or (2) lower prices, continue to work for free trade, and supply a larger share of a slightly increasing world market.

- Import restrictions are not in our best interest; they will merely move manufacturing jobs to other countries.
- If one cent of federal cigarette tax was designated to fund the tobacco programs, the farmers would be relieved of a heavy burden.

- [illegible]

[illegible]

[illegible]

- [illegible]

[illegible]

APPENDIX 8

A Resolution creating the Tobacco States Conference and establishing a Plan of Unity and Action:

WHEREAS, the tobacco states have met in the first Tobacco Conference of the States on April 20-21, 1985; and

WHEREAS, American tobacco producers are threatened by impacts of the [illegible]; and

WHEREAS, tobacco imports are rapidly threatening the continued existence of the American tobacco [illegible]; and

WHEREAS, a statement of unity by the tobacco-producing states [illegible];

NOW THEREFORE, BE IT RESOLVED BY THE TOBACCO CONFERENCE OF THE STATES ON APRIL 21, 1985:

Section 1. The Tobacco States Conference is hereby [illegible]

Section 2. [illegible]

Section 3. [illegible]

KENTUCKY'S POSITION

Kentucky hereby supports the following Plan of Unity and Action:

a. Manufacturers along with producer representatives be encouraged to enact a plan to minimize the growers no net cost, reduce tobacco imports, and increase the world-wide market shares.

b. If no agreeable plan is forthcoming from Congress, we hereby support a federal tax on cigarette manufacturers to pay for the cost of the no net cost program in support of tobacco farmers.

c. If a federal excise tax as described above is not forthcoming, then we support a state level manufacturers tax on the cigarette industry to support the no net cost program for tobacco farmers.

VIRGINIA'S POSITION

As we have previously stated at this conference, our primary interest in Virginia is the maintenance of a viable production adjustment/price support program. We feel that it is in the best interest of our producers, and without it the tobacco-producing industry in Virginia would suffer greatly.

Of the alternatives mentioned at this conference, the most attractive to us is the administrative proposal, whereby price supports would be reduced in return for an agreement by the buying companies to purchase all or a substantial portion of the loan stocks held by the tobacco loan cooperatives. We feel that this proposal is in the best interest of the entire tobacco industry.

In the event that this proposed program is not achieved, we in Virginia are open to the further study and consideration of other alternative proposals which have been presented at this conference.

Summary of the
Tobacco Program Improvement Act of 1985

Price Support

Lowers the price support level for the 1985 crop of burley tobacco to $1.45 per pound. (The bill assumes that the price support level for the 1985 crop of flue-cured tobacco will be lowered to $1.40 per pound administratively.)

Sets the price support level for the 1985 crop of any kind of tobacco (other than flue-cured and burley tobacco), using the same formula as in current law for the 1986 crops of such tobacco.

Sets the price support level for the 1986 and subsequent crops of flue-cured and burley tobacco at the level for the preceding year, plus or minus 65 to 100 percent of the total of --

(1) two-thirds of the amount by which the average market price for the 5 preceding years (excluding the highest and lowest years) is greater than the support level for the preceding year, and

(2) one-third of the change in the index of prices paid by tobacco farmers during the previous calendar year

Repeals the so-called Nunn amendment, giving the Secretary of Agriculture authority to lower the price support on certain low quality grades of flue-cured tobacco.

Determination of Marketing Quotas

Requires cigarette manufacturers to submit to the Secretary of Agriculture each year on a confidential basis their projections of the amount of flue-cured and burley tobacco they intend to purchase at auction during the next marketing year. The Secretary may determine the amount of intended purchases if not submitted by a manufacturer.

Requires the Secretary to set the national marketing quota for flue-cured and burley tobacco at (plus or minus 3 percent of the total of --

(1) the aggregate of the projections of intended purchases submitted by cigarette manufacturers,

(2) the average annual exports for the 3 preceding years, and

(3) the amount of tobacco the Secretary determines is needed to increase or decrease the inventories of the producer associations to establish or maintain such inventories at the reserve stock level.

Establishes reserve stock levels at the greater of (1) 100 million pounds for flue-cured and 50 million pounds for burley tobacco, or (2) 15 percent of the effective national marketing quota for the respective kind of tobacco.

Limits downward adjustments in the national marketing quota for burley tobacco to the greater of (1) 35 million pounds, or (2) 50 percent of the amount by which the quota initially determined for the marketing year is less than the quota for the preceding year.

Reduces the amount of flue-cured and burley tobacco that may be marketed without penalty from 110 to 103 percent of the farm marketing quota.

Auction Purchase Requirements

Requires cigarette manufacturers to submit to the Secretary of Agriculture on a confidential basis at the end of each marketing year the amount of purchases of [illegible] burley tobacco during the marketing year.

Subjects [illegible] to purchase at auction [illegible] inventories subject to the [illegible] percent of the amount of flue-cured and burley tobacco [illegible] to purchase for [illegible] penalty would be twice the per [illegible] less than 90 percent of [illegible]

[illegible] the total amount purchased [illegible] amount of [illegible] The purchase requirement [illegible] proportionally [illegible] marketing quota.

[illegible] appropriate [illegible]

[illegible]

[illegible] to pay to the [illegible] assessments on [illegible] from a farm [illegible] The amount of the assessment [illegible] and purchasers share [illegible]

[illegible] acquiring the tobacco, [illegible] marketed through such [illegible] producer to a person outside [illegible] responsible for collecting the [illegible] to the producer and add to the [illegible] assessment to be paid by the [illegible]

[illegible] any contribution or assessment [illegible] percent of the average market price of the tobacco involved on the quantity of tobacco as to which the failure occurs. The penalty would be assessed by the Secretary after notice and opportunity for a hearing, and review by the appropriate United States district court would be provided.

Purchase of Inventory Stock

Requires the flue-cured association to offer to sell its stocks from the 1976 through 1984 crops at the base prices in effect on October 29, 1984, reduced by 90 percent for tobacco from the 1976 through 1981 crops and 10 percent for tobacco from the 1982 through 1984 crops.

Requires the burley associations to offer to sell their stocks from the 1982 and 1984 crops at the base price in effect on July 1, 1985, for the 1982 crop and at the association's costs on the date of enactment of the bill for the 1984 crop.

Requires the Commodity Credit Corporation to take title to the 1983 crop burley tobacco held by the associations by calling the loans on such tobacco. Such tobacco would then be offered for sale on such terms and conditions as the Corporation deems appropriate. Any stocks not sold within two years after the loans are called shall be offered for sale at the associations' costs on the date the loans are called reduced by 90 percent.

Authorizes cigarette manufacturers to purchase the inventories as specified above over an eight-year period in the case of flue-cured tobacco and a five-year period in the case of burley tobacco. Each manufacturer would purchase a percentage of the stocks at least equal to the manufacturer's respective percentage of the total net cigarettes manufactured for use during a previous 12-month period as determined by the Secretary of Agriculture based on monthly reports submitted by manufacturers to the Department of the Treasury.

Requires approval of such purchase agreement by the Secretary, after consultation with the Attorney General.

Review of Tobacco Grading and Disaster Crop Designation

Requires the Secretary of Agriculture to conduct a study of the tobacco grading system and of the feasibility of establishing grades that would designate disaster crops, with authority for the Secretary to adjust the price support level for such grades.

Requires the Secretary to establish an advisory committee to provide recommendations with respect to the study issues.

Requires a report to the House and Senate agriculture committees on the study within 120 days after enactment of the bill and administrative action to implement, before the opening of the 1986 flue-cured marketing season, the study recommendations that can be implemented by the Secretary.

Investment of Tobacco Inspection Fees

Authorizes the investment of fees and charges collected under the Tobacco Inspection Act, with any income realized to be used to pay the expenses of the Secretary of Agriculture in providing services under that Act.

September 1985

EXPLANATION OF AMENDMENT TO S. 1418

In addition to making a number of technical and clarifying changes, the amendment makes the following substantive changes in S. 1418.

(1) The amendment makes two changes in the formula for determining the price support level for the 1986 and subsequent crops of Flue-cured and Burley tobacco. Under the bill, the adjustment in the price support level from one year to the next would be based on a formula that gives two-thirds weight to the difference between the average market price for tobacco for the 5 preceding years (excluding the highest and lowest years) and the support level for the preceding year, and one-third weight to the change in the index of prices paid by tobacco farmers during the previous calendar year.

The amendment changes the first factor to make it more clearly market oriented by basing any price support adjustment on the difference between the average market price for the 5 preceding marketing years (excluding the highest and lowest years) and the average market price for the 5 marketing years preceding the marketing year prior to the determination year (instead of the support level for the preceding year). The amendment also requires the Secretary of Agriculture to take into account 100 percent of the change in these two 5-year periods rather than 95 percent as in the bill.

(2) The amendment makes the repeal of the so-called Nunn amendment effective beginning with the 1986 crop of Flue-cured

tobacco instead of the 1985 crop as in the bill. This is basically a technical change since the price support level for the 1985 crop of Flue-cured tobacco has already been established using the Nunn amendment.

(3) The bill establishes a formula for determining the national marketing quota for Flue-cured and Burley tobacco that takes into consideration 3 factors: (1) tobacco purchases intended to be made by cigarette manufacturers, (2) average annual exports of tobacco for the 3 preceding years, and (3) the amount of tobacco the Secretary determines is needed to increase or decrease the inventories of the producer associations to establish or maintain such inventories at the reserve stock level. The bill also limits any downward adjustments in the national marketing quota for Burley tobacco to the greater of (i) 35 million pounds, or (ii) 50 percent of the amount by which total Burley tobacco inventories of the producer associations exceed the reserve stock level.

The amendment deletes the limitation on the downward adjustment in the national marketing quota for Burley tobacco and applies this same provision as a limitation on the downward adjustment in inventories under the third factor of the marketing quota determination formula. This clarifies the original intent of the bill.

(4) The amendment deletes the provision in the purchase requirement section that exempts a cigarette manufacturer from any penalty for not purchasing tobacco equal to at least 90 percent of its intended tobacco purchases if the total amount purchased by

all manufacturers is at least 90 percent of the total amount of intended purchases submitted by all manufacturers for purposes of determining the marketing quota. This would tighten the application of the purchase requirement by making the application of penalties with respect to one manufacturer depend only on the amount of tobacco that manufacturer purchases and not on what other manufacturers purchase.

(c) The amendment deletes the requirement that the Secretary establish an advisory committee to provide recommendations with regard to the study of the tobacco grading system that the Secretary is required to [illegible] under the bill. The Secretary has adequate authority to establish advisory committees if deemed necessary, and tobacco industry representatives will have adequate opportunity to have input into the study. Therefore, mandating another advisory committee is not necessary.

(d) The amendment [illegible] in the bill authorizing the investment by the Secretary of fees and charges collected under the Tobacco Inspection Act. The funds that could be invested would be [illegible] include late payment penalties and interest earned on the investment of the fees and charges. The amendment also makes it clear that such late payment penalties and interest would be credited to the current appropriation account incurring the cost of the service and would be available without fiscal year limitation. This amendment makes this provision consistent with similar authority recently enacted for the investment of other inspection and grading fees.

Explanation of Amendment Included In Conference Committee Report (December 1985)

On December 17, a conference substitute to S.1418 was adopted by the Conference Subcommittee considering the tobacco measure. The main changes of concern to burley interests in the substitute included:

1. Setting the price support for the 1986 crop of burley tobacco at $1.488 per pound, and

2. Establishing that for each of the marketing years 1986 through 1989, the national quota will not be less than 94 percent of the national marketing quota for the preceding marketing year; and not less than 90 percent of the previous year in 1990 through 1993.

APPENDIX 10

RESOLUTION

WHEREAS, tobacco production is at the heart of Kentucky's farm economy.

WHEREAS, loss of the tobacco program would have a devastating effect on Kentucky.

WHEREAS, the program remains in jeopardy because of imports, reductions in farmers' quotas and losses in market shares in the domestic and world market.

WHEREAS, the Tobacco Task Force was created by the Legislative Research Commission in 1984 to address problems which threaten the tobacco price support program.

WHEREAS, the task force has been instrumental in helping resolve those problems.

WHEREAS, the task force has provided leadership and unified the tobacco states in efforts to resolve the tobacco programs problems and the state must continue that leadership role.

WHEREAS, problems with the tobacco program remain that must be addressed by the task force.

NOW, THEREFORE, be it resolved by the General Assembly of the Commonwealth of Kentucky:

SECTION 1. That the 1986 General Assembly of the Commonwealth of Kentucky reauthorizes the Tobacco Task Force to continue to address the problems that face the tobacco program.