

# Tobacco

*The invisible hand plants first crop*

BY BETTY JOYCE NASH

## Buyout

**K**ent Hudson has bumped along tobacco road for 35 years, jumping at opportunity here and there.

“It’s like rolling logs on a river: You got to be steady on your feet and be ready to change directions,” he says. Hudson gave up growing tobacco in 1993 on his farm in the Piedmont near Buffalo Junction, Va., about a mile from the North Carolina line, midway between the mountains and the sea. He’s sold harvesters, planters, and tobacco barns. More recently, he’s been loading up 10- by 30-foot metal tobacco barns and hauling them from the Piedmont into the coastal plains of the Carolinas. That’s because tobacco production is headed east for big, flat plains where efficiency rules.

Competition is coming to tobacco fields as growers try the free market. The federal tobacco price support and quota program ended last fall by congressional legislation. Hudson’s new moving business bears out economists’ predictions that tobacco farming will migrate, for efficiency’s sake, to fields where topography enhances instead of hinders production. “Those that are quitting are selling the barns, and the people expanding are buying them,” he says. That pretty much sums it up.

Under the legislation, tobacco growers and quota owners will receive \$9.6 billion over 10 years, an effort to pay them for an asset — the right to grow tobacco — created more than 70 years ago by the federal tobacco program during the New Deal. (Another \$500 million will go toward disposition of tobacco held by grower associations.)



The new law lifts restrictions on location, size, and amount of tobacco production, leaving the market to decide who grows tobacco best.

### Tobacco in the Fifth District

Tobacco has been a cash crop since 1612, with flue-cured the most common type produced in the Carolinas and Virginia. Flue refers to the curing process, which uses forced air heat that was once circulated through a flue in the barn.

The biggest chunk of the nation’s \$1.75 billion 2004 tobacco receipts went to North Carolina: \$652 million. Kentucky ranked second, Virginia was third with \$127 million, and South Carolina, fourth with almost \$110 million. Even Maryland, which bought out all but about 150 growers five years ago,

*Ed Young’s family has raised tobacco in South Carolina since the 1800s. Young oversees planting of the first crop grown since the 1930s without price supports.*

raked in some \$3 million in 2004 tobacco cash, as did West Virginia. But antismoking sentiment and declining demand, falling exports, and competition from imported leaf had led to severe quota cuts over the past few years. Without price supports, the market might have sorted itself out years ago.

“Tobacco has been the backbone of agriculture in Southside Virginia for many, many years,” says tobacco specialist Stan Duffer of the Virginia Department of Agriculture and Consumer Services. “People knew how to grow tobacco. Now, we’re in a different time. Here in Southside

PHOTOGRAPHY: BETTY JOYCE NASH

you'll see some increase in livestock, beef cattle. It'll go back to supply and demand, I can assure you."

Controlling supply was the cornerstone of the federal tobacco program.

"The idea in economic terms is to restrict aggregate supply and hope you raise the price some," says Blake Brown, an economist at North Carolina State University who studies tobacco. The restrictions on many crops didn't endure like those on tobacco because of international competition. "But with tobacco, the international competition didn't become intense until the late 1980s and early 1990s." And when competition intensified, the price support program hamstrung tobacco farmers' ability to compete.

In the 1930s, farmers got quotas based on growing history. Tobacco quota became an asset. To expand, farmers either bought land with quota, rented land with quota attached, or bought quota and attached it to land. The buyout pays quota owners \$7 a pound over 10 years based on 2002 basic quota. Meanwhile, producers who raised tobacco in 2002, 2003, or 2004 will be paid \$3 per pound over 10 years if they grew tobacco all three years. Those who grew tobacco only one or two of those years will receive proportionately smaller payments. About 416,000 growers or quota owners are out there. The Environmental Working Group, a nonprofit that investigates farm subsidies, reports the average payment will be around \$4,396. But about 462 people, estates, or corporations will average about \$1.6 million apiece, according to the group's calculations.

Buyout money will be paid in 10 equal annual installments — for instance, for 500 pounds, a quota owner would get \$350 annually — or farmers may choose other payment options through financial institutions. (This bigger pot of money replaces the rest of the Phase II funds, about \$2.5 billion of the original \$6 billion, scheduled for growers and quota owners under the Master Settlement Agreement of 1998.)

Wachovia Corp. won a contract from the U.S. Department of Agri-

culture to mount a public information campaign to make sure tobacco farmers and quota owners know the ins and outs of the deal. The anticipated buyout money has uncorked a stream of financial planning seminars and charitable giving suggestions.

That's because payments, including those to Fifth District states, will be substantial: Growers and quota owners in North Carolina will receive about \$3.9 billion; South Carolina, \$724 million; and in Virginia, they will get almost \$667 million. Manufacturers and importers will foot the bill based on market share. (The three largest tobacco firms are in the Fifth District and include Philip Morris USA of Richmond, Va.; R.J. Reynolds Tobacco of Winston-Salem, N.C.; and Lorillard Tobacco Co. of Greensboro, N.C.)

It was essential to compensate quota owners, Brown notes. "You've created an asset with value whether you intended to or not," he says, adding that the original laws created the expectation that quota would continue to be valuable.

The buyout money will allow farmers with inefficient farms or without successors to retire, Brown says. (The average age of tobacco farmers is about 55.) Others will use the money to pay off debt. Some may develop businesses or retrain. Whether buyout money will stay local and work for these rural communities when farmers abandon tobacco, though, is unclear. "What you would hope is that quota owners who had been using quota rent as an income source will invest and if they make wise investments, the income will come back into these local communities to replace quota money," Brown says.

Out of Kent Hudson's five nearby neighbors, four quit. One will expand his road construction business, another bought a dump truck, another will add to his cattle herd, and another will work for the neighbor who is in the construction business. The loss of the tobacco crop will have an "effect on the car dealer, the pickup truck dealer, the fertilizer people, and the equipment people," Hudson says.

## Tobacco Tradition

Heading east on U.S. 176, just off Interstate 95 in Florence, S.C., there's an elegant white-columned home that dates from 1877. It's Ed Young's farm and he's the third generation to work that land. He still sleeps in the same bedroom where he was born. Young is 84 and aptly named because he climbs in and out of his big cab pickup truck easily in spite of a recent hip replacement. On a windy day in late April, Young stands in a field of about 32 acres. A carousel planter, named for its rotating part that deposits tobacco seedlings, crawls along. There are typically 6,000 plants to the acre on these South Carolina fields of sandy loam. Young should know, as his family has grown tobacco here since the late 1800s. Young's uncle met with Franklin D. Roosevelt before the president created the tobacco program.

This year, Young planted the same amount of acreage in tobacco under these new market conditions as he did last year under the old quota system, 65 acres compared to the 100 or so he planted three years ago. He is waiting to see what changes the market brings.

"I'm gonna take a chance," he says. "We have a contract with Reynolds." R.J. Reynolds Tobacco Co. is the nation's second largest tobacco company, with about one-third of the domestic cigarette market, behind Philip Morris USA, with about half the domestic market.

This year, tobacco growers without contracts with manufacturers or leaf merchants aren't likely to plant. The contract system replaced the outdated auction warehouses several years ago. The Reynolds contract instructs Young and other growers in his area to ditch the bottom (less valued) eight tobacco leaves of the tobacco plant's 19 leaves, which will cut the yield by 20 percent, Young says. Some farmers chose not to plant because they didn't think they could make money. Dewitt Gooden, tobacco specialist with Clemson University, reckons that this year there'll be about 25 percent less tobacco planted in this region compared to last year.

## Maryland Tobacco Settlement Payments in Limbo

Most of Maryland's tobacco farmers agreed to a buyout in 1999, when the state pledged to use money from the Master Settlement Agreement's Phase II to compensate them for getting out of tobacco. But those payments ended when the tobacco buyout legislation was passed last fall, leaving Maryland farmers in the lurch.

Maryland farmers opted out of the federal price support system in the 1960s; none will receive money from the current federal buyout program. Pennsylvania tobacco farmers are in the same boat, since they also did not participate in the federal tobacco program.

"We had roughly 1,000 individuals receiving payments from the trust whose payments are now in jeopardy," says Patrick McMillan, an assistant secretary of the Maryland Department of Agriculture. Maryland farmers had seven payments remaining, worth a total of about \$12 million.

Farmers covered by the Master Settlement Agreement have not received money for 2004 because tobacco companies say they're not obliged to make that payment now that the buyout has replaced the Phase II schedule.

The matter is now with the North Carolina Supreme Court. Original trust papers gave the

North Carolina courts jurisdiction in tobacco settlement matters. "[Growers] are losing this stream of revenue they anticipated when they made their decision," McMillan says. "It's very unfair to them."

Farmers participating in the Maryland program are paid \$1 per pound annually over 10 years, based on the average amount of tobacco produced between 1996 and 1998. In exchange, farmers agreed to quit growing tobacco and use the land to grow other crops for at least 10 years. By 2005, 86 percent of producers were taking the buyout.

Maryland tobacco farmers have always been a different breed: They grew the unique Type 32, known for slow and even burning.

The tobacco was sought after in the European market and prices over the years were strong. And domestic firms bought the grades the Europeans didn't want. That's probably one of the biggest reasons why Maryland farmers decided to get out of the federal program, says David Conrad, regional tobacco specialist with the University of Maryland's cooperative extension service. "When you put those prices [domestic and European] together, there was no need for price supports," he says. — BETTY JOYCE NASH

Young would like to expand, if the market warrants. His children, grown and far-flung, are unlikely to carry on farming. Raw land near his farm sells for \$20,000 an acre, and substantial subdivisions are plopped down adjacent to fields. "It's hard to farm land worth \$20,000 an acre," he says.

Tobacco contract prices, says Blake Brown of N.C. State, have fallen by the amount of the quota rent — about 40 cents to 50 cents a pound. The farmers with the most competitive yields will make money; others will not. Field size, fixed costs, equipment costs, labor costs, and good management will determine profitability, like any other business, says Brown. But the single biggest factor to success is the productivity of the land itself.

Oversupply from last year's crop kept contract amounts low this year, says Jim Starkey, senior vice president of Universal Corp., based in Richmond, one of the biggest leaf merchants in the world. Without production limits, the better farmers will grow more under contract, Starkey says. Taking the quota price out of the equation removes a nonproductive cost from the system, he notes.

"What a grower actually receives will depend on what he actually produces in a given year," Starkey says. "If he has a good year and produces a higher quality tobacco, his income will go up."

Even though production of flue-cured tobacco will increase in the coastal plains, there will be some tobacco grown in the Piedmont, Brown says. That's because buyers like to spread risks and avoid weather extremes or other possible production problems. Jim Starkey says Universal has contracts in all five flue-cured producing states. Some flue-cured tobacco farmers will

try growing burley tobacco now that there are no restrictions on where certain tobaccos can be grown. Burley was traditionally raised on the fringes of the Appalachians. Burley is labor-intensive and grown in a slightly cooler climate than flue-cured. The entire stalk is cut, hung, and air-cured. Starkey says humidity prevents burley production in the tropics, the source of most international tobacco competition.

"In the case of burley, I think the core will still be in Kentucky and Tennessee, but since so many growers will be getting out of the burley production area, I think we'll start to see that production move to new areas and the Piedmont is one," Starkey says.

Most mountain burley growers will quit tobacco because the steep terrain and small plots curtail efficiency. Without the guaranteed tobacco price, they won't make money. Some growers in the Piedmont are planting burley, but, of course, it's untried and risky.

Ed Young watched his father turn to dairy after the boll weevil wiped out cotton. He's lived to see cotton revive and dairy production move on to greener pastures. He plans to invest in equipment and perhaps in another farm. Other farmers in his neighborhood are putting land in timber or trying new agricultural enterprises. As for the rest, the money greases the way out. **RF**

### READINGS

Brown, A. Blake. "U.S. Flue-Cured Tobacco Outlook and Situation." Department of Agricultural and Resource Economics, North Carolina State University, Dec. 8, 2004.

Brown, A. Blake, and Laura L. Martin. "Price versus Quota Reductions: U.S. Flue-Cured Tobacco Policy." *Journal of Agricultural and Applied Economics*, December 1996, vol. 28, no. 2, pp. 445-452.

Johnson, Paul R. *The Economics of the Tobacco Industry*. New York: Praeger Publishers, 1984.

Visit [www.richmondfed.org](http://www.richmondfed.org) for links to relevant sites and supplemental information.