21701

REPORT BY THE

Comptroller General

OF THE UNITED STATES

Tobacco Program's Production Rights And Effects On Competition

The Department of Agriculture's tobacco program, through its acreage allotment, marketing quota, and price-support provisions, is affecting the competitiveness of the U.S. tobacco industry in world and domestic markets and the income of those farmers who grow tobacco. GAO found that 68 percent of the allotment and quota owners in 32 counties selected for review were not active farmers. Instead, they leased or rented their production and marketing rights to producers at rates ranging from 25 cents to 90 cents a pound.

While the United States still enjoys a highly favorable balance of trade in tobacco ($2.2 billion in 1981), the high price of U.S. tobacco and the improved quality and increased production of foreign tobacco have helped cause the U.S. share of world tobacco trade and domestic use to decline.

Insufficient markets for U.S. flue-cured tobacco have resulted in a 32.1-percent reduction in the national flue-cured tobacco quota since 1975. Reductions in individual farm quotas in turn require tobacco producers to lease or rent quotas from others to maintain existing production levels.

UNITED STATES GENERAL ACCOUNTING OFFICE

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APRIL 23, 1982

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COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON D.C. 20548

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April 23, 1982

The Honorable Mark O. Hatfield
Chairman, Committee on Appropriations
United States Senate

The Honorable Thomas F. Eagleton
Ranking Minority Member, Subcommittee
on Agriculture, Rural Development,
and Related Agencies
Committee on Appropriations
United States Senate

As requested in your September 29, 1981, letter, this report provides certain information on the current Federal price-support program and system of acreage allotments and marketing quotas for tobacco. Certain requested information, the quantity of tobacco marketed as warehouse floor sweepings, is of a proprietary nature and is being transmitted separately.

At your request, we did not take the additional time needed to obtain agency comments. As arranged with your offices, unless you announce its contents earlier, we plan no further distribution of this report until 30 days from its issue date. At that time, we will send copies to interested parties and make copies available to others upon request.

Milton J. Socolar

Acting Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT

TOBACCO PROGRAM'S PRODUCTION RIGHTS AND EFFECTS ON COMPETITION

D I G E S T

Significant changes have occurred in the Department of Agriculture's tobacco program since its inception in 1938. Most owners of tobacco production and/or marketing rights now rent or lease them to others. GAO's statistical sample in six major tobacco-producing areas and regions--four burley areas and two flue-cured regions--showed that farmers who grow tobacco, once the program's intended beneficiaries, owned only 40 percent of the farms with acreage allotments and marketing quotas. Most owners were retired farmers; widows of farmers; and nonfarming owners such as doctors, teachers, realtors, truck drivers, government employees, and construction workers. (See p. 9.)

Of the owners in the six areas and regions, about 26 percent rented and 42 percent leased their allotments and/or quotas to others who actually grew and marketed the tobacco. (In a rental situation the producer grows the tobacco on the owner's base farm. In a leasing situation the tobacco is grown on another farm in the same county.) The remaining owners either grew and marketed the tobacco themselves (26 percent), allowed a relative to grow it (4 percent), leased part and grew part (1 percent), or did not use the allotments/quotas at all (1 percent). (See pp. 9 and 11.)

Prices for leases in the sampled areas and regions ranged from 25 cents to 80 cents a pound in flue-cured counties and 25 cents to 90 cents a pound in burley counties. Also, the Department estimated that 1981 share rental (owner and producer share in the sale proceeds) rates in dollar terms averaged 39 cents a pound for flue-cured tobacco and 51 cents a pound for burley tobacco. (See p. 12.)

Leasing was first authorized in 1961. At that time Department tobacco experts estimated that about 2 percent of the tobacco allotment and quota owners would lease the rights to others. In 1981 in the regions and areas GAO reviewed, about 57 percent of the quota owners in the flue-cured tobacco-producing counties and 27 percent of the quota owners in the burley

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counties leased their rights to others. Some factors which have led to increased leasing include the high cost to purchase land with quotas and farms that have allotments but no longer have tillable cropland. (See pp. 11 and 14.)

U.S. TOBACCO IS BECOMING LESS COMPETITIVE

Although meaningful price comparisons of U.S. and foreign tobacco are difficult to make because of quality differences, the price of U.S. tobacco is by far the highest of any on the world market. For example, in 1980 the estimated average price of exported U.S. flue-cured tobacco was $2.48 a pound compared with Canada's estimated average export price of $1.61 a pound and Zimbabwe's 88 cents a pound. (See p. 19.)

The best U.S. flue-cured tobacco is generally superior in flavor, aroma, and nicotine content to tobacco grown in most other countries. However, that quality gap is closing. For example, Zimbabwe, a major competitor, sold its 1981 crop for a record price for that country. The high price was attributed to improved quality. (See p. 18.)

The high price of U.S. tobacco and the improved quality and increased quantity of foreign tobacco have helped cause the U.S. share of the world market for flue-cured tobacco to decline from 46 percent in 1970 to 29 percent in 1980. During this period U.S. use of foreign flue-cured tobacco grew from less than 2 percent to 13 percent. Nevertheless, the U.S. balance of trade in tobacco is still highly favorable--$2.2 billion in 1981. (See p. 17.)

According to the Secretary of Agriculture, the legislated price-support formula, which establishes minimum prices for U.S. tobacco, has increased the price of U.S. tobacco without regard to changes in production costs and competing countries' prices. The Secretary has asked the Congress for authority to adjust the price-support levels for various kinds of tobacco. The Secretary has stated that this authority could help make flue-cured tobacco more competitive and curtail the amounts of low-quality U.S. flue-cured tobacco coming under Government loan. (See p. 21.)

PROGRAM'S EFFECTS ON FARM INCOME

The tobacco program's high support prices--about $1.42 and $1.46 a pound for flue-cured and burley in 1980 (up from 93 cents and 96 cents in 1975)--have helped make U.S. tobacco, particularly low-quality flue-cured tobacco, less competitive in both U.S. and world markets. The lower demand has led in turn to quota reductions. For example, between 1975-81 the quota for flue-cured tobacco was reduced 478.8 million pounds, from 1,491.4 million pounds to 1,012.6 million pounds.

Therefore, while the high support prices have increased per-pound income, total income may not have increased because of the quota reductions. The impact on income would depend on how responsive tobacco purchasers were to price increases.

Also, lease and rental costs reduce the producers' net income. The prices received for leasing and renting reflect the market value of the rights. Because most tobacco growers have to lease or rent these rights, they earn less than they would if they owned the rights and grew the same amount of tobacco. (See pp. 16, 17, 19, and 20.)

PROGRAM COSTS

The Government's costs for the program include administrative costs--an estimated $13.1 million in 1981--and losses on disposals of tobacco used as collateral on price-support loans from the Department's Commodity Credit Corporation--$57 million in loan principal has been lost since program inception in the 1930's.

More significant, however, are the Government's interest costs and losses. The Corporation has incurred large losses through interest repayment practices, initiated in 1966, which allow loan payments to be applied first to the principal amount outstanding rather than to accrued interest. This practice cost the Corporation $2 million in fiscal year 1980 alone on loans for just 3 crop years. Also, before April 1981 the Corporation made loans at below-market interest rates. The Department's estimates indicate a $591 million difference between the Corporation's interest payments to the U.S. Treasury ($845 million) and its interest income ($254 million) from inception of the program through September 1980. (See pp. 23 and 24.)

On April 1, 1981, the Corporation began to charge interest rates comparable to those the U.S. Treasury charges it. However, it continues to allow loan payments to be applied first to loan principal, until liquidated, and then to accrued interest. GAO recommended in a January 1982 report (AFMD-82-40) that this practice be changed. As of April 1, 1982, the Corporation had not acted on the recommendation. (See p. 24.)

FLOOR SWEEPINGS BRING HIGH PRICES

The Department-established floor sweepings allowance enables warehouses to market, for their own profit, scraps or leaves of tobacco left on the floor after an auction sale has been completed. GAO's review at six flue-cured and six burley warehouses showed that their floor sweepings generally brought prices that approached the average market price of tobacco sold for producers. For example, flue-cured floor sweepings sale prices, which ranged from $1.41 to $1.69 a pound, were only slightly below the average market prices, which ranged from $1.60 to $1.72 a pound. (See p. 27.)

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The Chairman of the Senate Appropriations Committee and the Ranking Minority Member of that Committee's Subcommittee on Agriculture, Rural Development, and Related Agencies requested the report. They asked GAO to provide certain information on the current Federal price-support program and system of acreage allotments and marketing quotas for tobacco. They also requested that GAO not take the additional time needed to obtain agency comments.

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ABBREVIATIONS

AMS	Agricultural Marketing Service
ASCS	Agricultural Stabilization and Conservation Service
CCC	Commodity Credit Corporation
ERS	Economic Research Service
GAO	General Accounting Office
OIG	Office of Inspector General
USDA	U.S. Department of Agriculture

CHAPTER 1

INTRODUCTION

By letter dated September 29, 1981, the Chairman of the Senate Appropriations Committee and the ranking minority member of that committee's Subcommittee on Agriculture, Rural Development, and Related Agencies asked us to obtain information on certain aspects of the U.S. Department of Agriculture's (USDA's) tobacco price-support program. These were (1) who owns the tobacco allotments and quotas that are leased or rented, (2) the amount and average cost of the leased or rented allotments and quotas, (3) the effects of the current price-support program on the long-term competitiveness of U.S. tobacco in the world marketplace and on farmer income, (4) the potential for averting future price-support loan program costs by authorizing the Secretary of Agriculture to adjust price-support levels for the kinds of tobacco that are not competitive on the world market, and (5) the quantity of tobacco warehouses are marketing as floor sweepings.

THE TOBACCO PROGRAM

The Agricultural Adjustment Act of 1938 (7 U.S.C. 1281 *et seq.*) signaled the beginning of a large-scale Federal program to help stabilize, support, and protect farm income and prices. Its purpose was

> "* * * to assist in the marketing of agricultural commodities for domestic consumption and for export; and to regulate interstate and foreign commerce in cotton, wheat, corn, tobacco, and rice to the extent necessary to provide an orderly, adequate, and balanced flow of such commodities in interstate and foreign commerce through storage of reserve supplies, loans, marketing quotas, assisting farmers to obtain, insofar as practicable, parity prices for such commodities and parity of income, and assisting consumers to obtain an adequate and steady supply of such commodities at fair prices."

The act gave USDA authority to regulate production of tobacco through acreage allotments (acres planted) and marketing quotas (pounds marketed). Later, the Agricultural Act of 1949 (7 U.S.C. 1421 *et seq.*) gave USDA's Commodity Credit Corporation (CCC) authority to provide for price stabilization and support operations through price-support loans to tobacco producer associations. The associations use the funds to make cash advances to producers unable to sell their tobacco for at least the price-support rate assigned to the individual grades of tobacco.

Price support is available for nine kinds of tobacco; however, the two primary ones, flue-cured and burley, which are the subjects of this report, account for 63 and 29 percent, respectively, of United States and Puerto Rican tobacco production for crop year 1979, and 78 and 19 percent, respectively, of the price-support loans made from 1975-80. USDA's Agricultural Stabilization and Conservation Service (ASCS) is responsible for regulating the acreage allotment, marketing quota, and price-support programs. State and county farmer-elected committees administer the programs at the local level. County office operations are supervised by a county executive director hired by the county committee.

Marketing quotas and acreage allotments

The 1938 act specifies that in order for marketing quota and acreage allotment programs to be established and regulated by USDA, the programs must be approved in a referendum by a two-thirds majority of eligible voters. Marketing quotas for the 1980-82 crop years were approved by 98 percent of the flue-cured tobacco producers and 99 percent of the burley tobacco producers. In addition, flue-cured tobacco producers again agreed to an acreage allotment program.

The marketing quota specifies the pounds of tobacco that may be sold from a qualifying farm without penalty during the marketing year. The allotment specifies the maximum acreage of tobacco that may be planted on the farm during the year. A farm can market up to 10 percent more than its stated quota, but the excess is deducted from the following year's quota. Marketings above the 10-percent allowable excess are subject to a penalty charge. The charge amounts to 75 percent of the average market price for the previous year.

To be eligible for an allotment and/or quota, a farm must either have established a production base traceable to the 1930's when the tobacco program began or subsequently have been granted an allotment or quota by ASCS. Allotments and/or quotas are assigned to a particular farm and may not be sold independently of the land. An owner of a farm's allotment and/or quota may produce the farm's quota on that farm or, by use of a lease, transfer part or all of the farm's allotment and/or quota to another farm within the same county. The owner may also share or cash rent the quota to a producer, giving that producer the right to grow the tobacco on the owner's base farm.

Each year the Secretary of Agriculture determines the national marketing quota for each kind of tobacco. The national quota is a projection of the production needed to meet domestic and export demand and to provide for reasonable carryover stocks. The national quota determines acreage allotments and marketing quotas for individual farms as each tobacco farm, based on its historical production, is given a pro rata share of the national quota. For the 1981 crop year the national quota for flue-cured tobacco was 1,112 million pounds and for burley tobacco, 851 million pounds.

Price-support program

Price-support levels are based on the concept of parity. Parity is a general or overall standard which applies to the average of the various locations, grades, qualities, and classes of the commodity as sold by all farmers. Parity prices, the most commonly used parity standard, are those prices that will give farm commodities the same purchasing power they had in a selected base period when prices received and paid by farmers were considered to be in good balance. The formula for computing parity prices is set forth in the Agricultural Adjustment Act of 1938, as amended.

Flue-cured and burley producers market their tobacco in auction warehouses. There it is weighed, identified by a warehouse sales ticket, and displayed in lots (baskets, sheets, or piles) on the auction floor. A USDA Agricultural Marketing Service (AMS) tobacco inspector grades the tobacco in each lot and marks the grade on the warehouse sales ticket. Potential buyers then bid on the lots. If the highest bid price on any lot of tobacco is not equal to or more than the grade's price-support rate, the producer may put the tobacco under loan at the price-support rate or wait and market the tobacco at a later date hoping for a higher bid price.

USDA does not directly administer the price-support program. Instead, it contracts with 13 producer cooperative associations for that purpose. Price support is extended by means of nonrecourse loans made through the associations to their members, with financing by CCC. The nonrecourse loans absolve producers from liability for any losses incurred from the sale of the tobacco by the producer associations. Net gains, if any, are distributed to the producers based on participation, whereas losses are absorbed by CCC. Since the program began, CCC has loaned about $5 billion to associations. For those crop years where the tobacco taken under loan has been sold, $57 million in principal was not recovered. As of December 1981 principal on flue-cured tobacco loans totaling $640 million were outstanding for the 1975-80 crop years.

The associations are allowed to deduct 1 cent a pound from the loan rate to cover administrative costs. The associations handle all operations related to making the loan advances to producers and receiving, processing, storing, and eventually selling the tobacco taken under loan. Over time, the associations market the tobacco under loan on the basis of prices proposed by the associations and approved by CCC. Sale proceeds are applied toward repayment of the principal first and then the interest on the loans.

OBJECTIVES, SCOPE, AND METHODOLOGY

This report provides information on certain aspects of ASCS' flue-cured and burley tobacco programs. In response to the request, our objectives were to determine (1) by occupation or source of income, the owners of tobacco allotments and quotas that are leased or rented, (2) the amounts and average costs of the leased or rented allotments and quotas, (3) the program's long-term effects on the competitiveness of U.S.-grown tobacco and on farmers' income, (4) the potential for averting future loan program costs by authorizing the Secretary to adjust price-support levels for the various kinds of tobacco, and (5) the amount of the tobacco that warehouses market as floor sweepings.

We conducted much of our review at ASCS headquarters in Washington, D.C.; at ASCS' State offices in Kentucky and North Carolina; and at 32 ASCS county offices in Kentucky, North Carolina, Tennessee, and Virginia.

In selecting the counties to be reviewed, we coordinated with an economist in USDA's Economic Research Service (ERS). We randomly selected 16 counties from the 2 USDA-designated agricultural regions that produced 53 percent of the flue-cured tobacco grown in the United States in crop year 1979. We also selected 16 counties from the 4 USDA-designated agricultural areas that grew 48 percent of the 1976 (based on available USDA data) domestic burley tobacco crop. The 32 counties selected for review and the amounts of tobacco produced in each in 1979 are shown in appendixes I and II.

We then randomly selected 30 farms within each county from which to obtain acreage allotment, marketing quota, and price-support information. We used appropriate weights in selecting the farms so that the information obtained from this statistically valid sample could be projected, at a 95-percent confidence level, to the six agricultural regions and areas we reviewed. The 85 counties in these regions and areas and the number of farms in each county also are shown in appendixes I and II. The maps on pages 6 and 7 show the regions, areas, and counties selected for review.

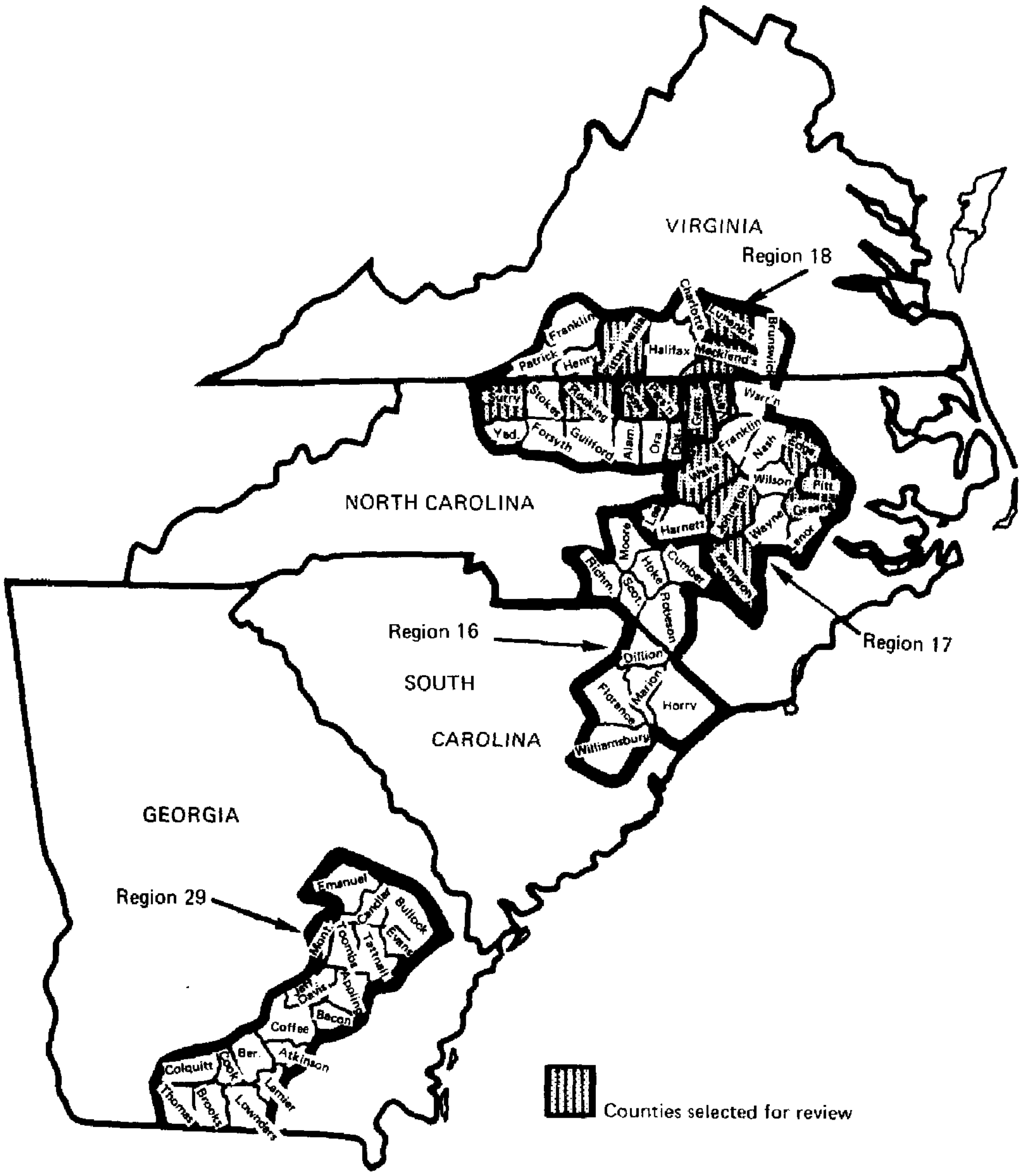
We visited 12 warehouses in the selected counties to obtain information on the amounts and sale prices of the floor sweepings marketed in the 1981-82 marketing year. We chose the individual warehouses judgmentally on the basis of the quantities--large, medium, and small--of floor sweepings they had marketed. We also obtained aggregate information from ASCS on floor sweepings activity for the 550 warehouses nationwide that market flue-cured and burley tobacco. However, because public disclosure of this aggregate information is prohibited by the Agricultural Adjustment Act of 1938 (7 U.S.C. 1373(c)), we are providing it to the requestors under separate cover.

We made the review in accordance with our "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions." We reviewed applicable legislation, implementing regulations, and pertinent USDA policies and procedures. We interviewed ASCS and AMS officials in Washington and the field and obtained their views on matters discussed in this report. ASCS and ERS provided publications on the tobacco program. We also coordinated our work with USDA's Office of Inspector General (OIG), interviewed its personnel knowledgeable about the tobacco program, and reviewed its applicable audit reports. In addition, we reviewed an August 1981 report on imported tobacco by the United States International Trade Commission.

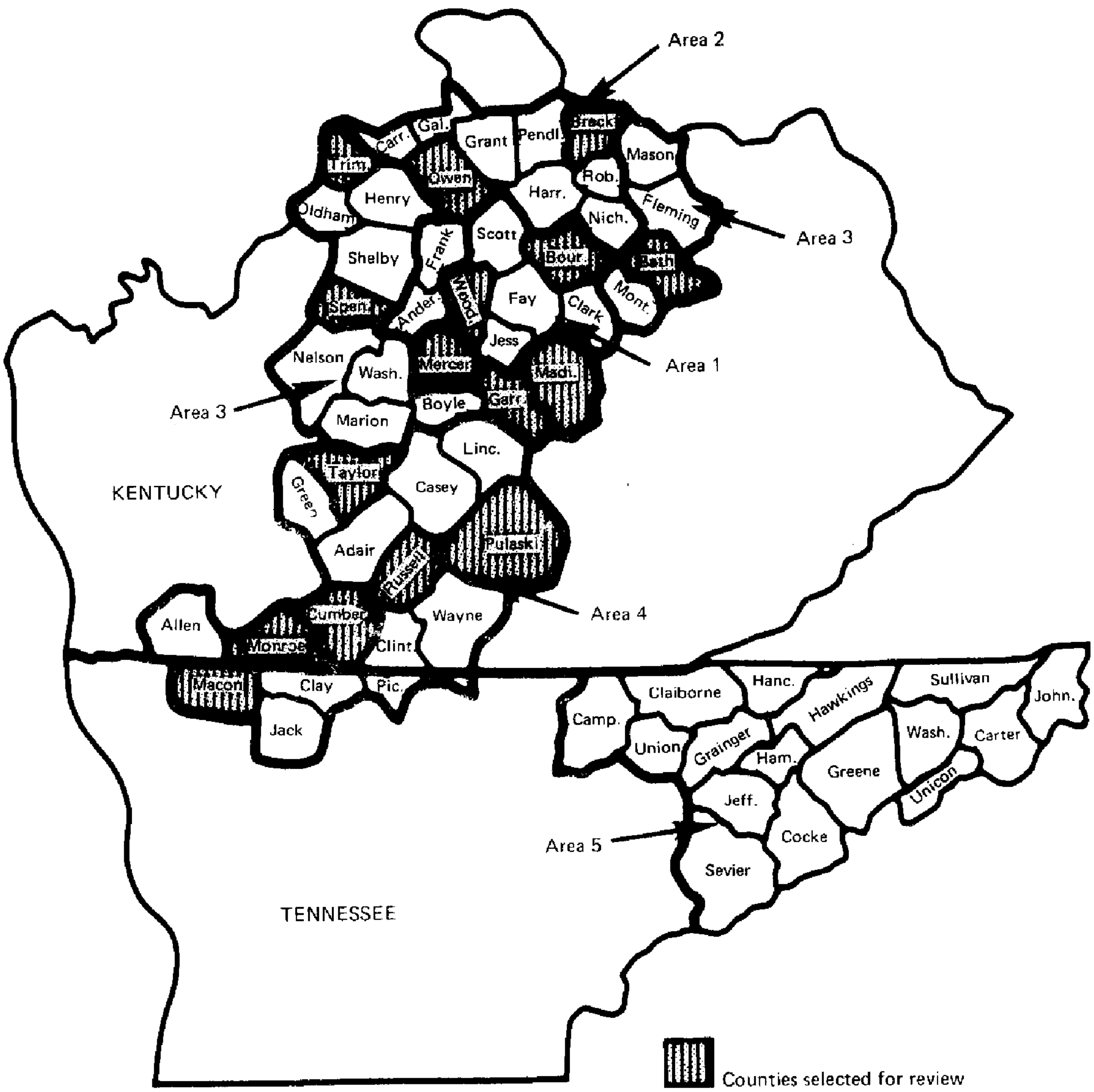
We reviewed ASCS county office files for the 1981 crop year. They showed the allotment and quota owners' names and addresses but did not contain information on the owners' primary occupations or sources of income. ASCS county office employees generally have some personal knowledge of most owners, and this was the primary basis for our categorization of owners. In those cases where the county office employees did not know the occupation of the owners, we or the county employees contacted the owners directly to obtain the information.

We interviewed officials of major tobacco manufacturing and export and import corporations. We obtained the views of producer organizations; researchers; lending institutions, including producer cooperative associations, banks, and savings and loan associations; and universities. We also interviewed warehouse owners, tobacco producers, and farm owners who lease or rent quotas.

COUNTIES SELECTED FROM U.S. DEPARTMENT OF AGRICULTURE--DESIGNATED AGRICULTURAL REGIONS IN WHICH FLUE-CURED TOBACCO IS GROWN



COUNTIES SELECTED FROM U.S. DEPARTMENT OF AGRICULTURE--DESIGNATED AGRICULTURAL AREAS IN WHICH BURLEY TOBACCO IS GROWN



CHAPTER 2

THE CHANGING TOBACCO PROGRAM

Significant changes have occurred in the tobacco program since its inception. Originally, the owners of the acreage allotments and marketing quotas were the farmers who grew the tobacco. But this is no longer the case. Many tobacco allotment and quota owners have developed alternative uses for their labor and land resources and lease or rent the allotments and quotas to others. Other factors such as the high cost of land with an allotment or quota, tobacco allotments on farms with no tillable land, and high lease and rental rates also have encouraged leasing and renting activity. In the six regions and areas we reviewed, most of the farms with tobacco production and/or marketing rights were owned by nonfarmers who did not grow tobacco but leased or rented the production and/or marketing rights to others.

The U.S. balance of trade in tobacco is still highly favorable--$2.2 billion in 1981--but foreign tobaccos are gaining larger shares of both the world and U.S. markets. The high price of U.S. tobacco and the improved quality and increased quantity of foreign tobacco have helped cause the U.S. share of flue-cured tobacco traded on the world market to decline from 46 percent in 1970 to 29 percent in 1980. During this period U.S. use of foreign flue-cured tobacco increased from less than 2 percent to 13 percent.

Tobacco producers' income is affected by the high cost of leasing or renting quotas and reductions in quotas brought about by the loss of markets for U.S. tobacco. In the counties we reviewed, producers paid from 25 cents to 90 cents a pound to acquire 1981 crop year quotas.

The price of U.S. tobacco, based on the legislated support formula, is well above that of foreign tobacco. The high price of U.S. tobacco, in turn, has resulted in the accumulation of undesirable, hard-to-sell flue-cured tobacco in CCC inventories. The Secretary of Agriculture has asked the Congress for authority to adjust the price-support levels for the various kinds of tobacco in order to limit the quantity of tobacco coming under loan. A reduction of these support levels should encourage a reduction in U.S. tobacco prices, which could make U.S. tobacco more competitive in domestic and foreign markets.

Many of the problems discussed in this report relate more to flue-cured tobacco than to burley tobacco. This is due mainly to a weak market for low-quality U.S. flue-cured tobacco and a strong demand for less abundant burley tobacco in recent years. However, the shortage of and strong demand for burley tobacco may not continue. If the situation changes, the problems also could relate to burley tobacco. For example, higher prices for burley tobacco, due to tight world supplies, already have stimulated production in Italy, Spain, Korea, and Mexico. Good weather and little disease also could increase production. (Climate, disease, and production preferences in foreign countries are some of the factors that influence the supply of and demand for tobacco but are not discussed in this report.)

MOST OWNERS RENT OR LEASE PRODUCTION RIGHTS

Farmers who grow tobacco were the intended beneficiaries of the allotment and quota provisions when the program was established. Only 40 percent of the farms in our review, however, were owned by full- or part-time farmers. Retired farmers; widows of farmers; and nonfarming owners such as doctors, teachers, realtors, truck drivers, and construction workers made up the majority of the owners. Some of these people are the original allotment and quota owners or their heirs but are no longer farmers. Others have purchased these rights.

Additionally, only 26 percent of the owners in our review actually grew tobacco. About 68 percent of the owners leased or rented their production rights to others who grew it. About 1 percent of the owners leased some and grew some of their quota. The remaining 5 percent either allowed a relative to grow and market the quota or allowed the quota to go unused.

When the tobacco program was established, farms already growing tobacco were assigned nontransferable allotments or quotas and only those farms were permitted to market tobacco. By the 1960's many flue-cured and burley tobacco farms became so small that the owners of the allotments and quotas frequently found that planting tobacco was uneconomical. In 1961 (1971 for burley) the Congress authorized tobacco allotment/quota holders to transfer, by lease, all or any part of the allotments/quotas to another tobacco producer in the same county. In 1961 USDA tobacco experts estimated that such an authorization would be exercised by about 2 percent of the flue-cured tobacco growers. Since then there has been a shift from farm owners growing their own tobacco to the present situation where most farm owners do not grow tobacco.

ASCS maintains and reports statistical information on tobacco leasing activities; that is, the number of farms and the acreage and/or quota that is leased off the base farm. The agency, however, does not record and report the number of rentals; that is, the number of farms and acreage and/or quota that is cash or share rented to a producer, giving that producer the right to grow the tobacco on the owner's base farm. As a result, the agency does not know to the full extent the number of owners who do not produce tobacco.

We reviewed agency records on leasing activities, interviewed ASCS county office personnel knowledgeable about leasing and renting activities in their counties, and contacted farm owners to obtain lease and rental information on the 960 farms in our sample. The information on the sample farms disclosed that about 57 percent of the owners in the flue-cured tobacco regions and about 27 percent in the burley areas leased out their quotas. The percentage of owners that rented their quotas was the same for both types of tobacco--26 percent. However, 40 percent of the burley owners grew their quotas compared with only 12 percent of the flue-cured owners. The table on the following page identifies the amount of rental, leasing, and growing activity on the 960 sample farms in the flue-cured regions and burley areas.

On the basis of our weighted sample, we project that about 68,000 of the 83,941 farms in the two flue-cured regions reviewed and about 37,000 of the 75,302 farms in the four burley areas reviewed lease or rent their tobacco quotas. The remaining farms, approximately 20 percent in the flue-cured regions and approximately 51 percent in the burley areas, either grow the tobacco themselves, allow a relative to grow it, or do not plant tobacco at all. Additional projections on how tobacco quotas are used in the flue-cured regions and burley areas we reviewed are found in appendix III.

Categorizations of the owners

We compiled information on the owners' occupations or primary sources of income in two ways. One provides a breakout of the owners of all 960 farms included in our sample and, as requested, the other provides a breakout of the 649 farms with quotas that were leased or rented for crop year 1981. Both breakouts indicate that only a small portion of the farms are owned by active farmers.

Our analysis of the owners of all 960 farms disclosed that 28 percent of the owners (36 percent of the burley owners and 21 percent of the flue-cured owners) were full-time farmers. Part-time farmers accounted for an additional 12 percent (20 percent of the burley owners and 3 percent of the flue-cured owners). Retired farmers and widows of farmers accounted for another 25 percent but the remaining 35 percent (46 percent for flue-cured and 25 percent for burley) were unknown or nonfarmers. The nonfarmers included doctors, teachers, realtors, tobacco warehouse operators, and government employees. A categorization of the owners of all 960 farms by occupation or source of income is presented in appendix IV.

As could be expected, active full- and part-time farmers made up an even smaller portion of the owners (20 percent) when only the 649 farms that leased or rented quotas were considered. The table on page 12 identifies the occupational categories of those farm owners.

Summary of Quota Use (note a)

Use of owner's quota	Flue-cured				Burley				Total			
	Number	Percent	Pounds	Percent	Number	Percent	Pounds	Percent	Number	Percent	Pounds	Percent
			(000 omitted)				(000 omitted)				(000 omitted)	
Leased	272	56.7	1,325	24.7	b/129	26.9	294	10.8	b/401	41.8	1,619	20.0
Rented	124	25.8	2,555	47.6	124	25.8	1,103	40.5	248	25.8	3,658	45.2
Leased and grown	5	1.0	151	2.8	1	.2	14	.5	6	.6	165	2.0
Grown	59	12.3	1,103	20.5	194	40.4	1,226	44.9	253	26.4	2,328	28.8
Grown by relative	12	2.5	180	3.4	28	5.9	85	3.1	40	4.2	265	3.3
Not grown	8	1.7	55	1.0	4	.8	5	.2	12	1.2	60	.7
Total	480	100.0	5,368	100.0	480	100.0	2,727	100.0	960	100.0	8,096	100.0

a/Some figures may not add due to rounding.

b/Because the marketing season was not complete at the time we finished our audit work, 27 tentative lease agreements were included based on historical lease patterns.

Categorization of Owners Who Lease or Rent Quotas (note a)

	Flue-cured		Burley		Combined	
	Number	Percent	Number	Percent	Number	Percent
Farmers:						
Full-time	52	13.1	32	12.7	84	12.9
Part-time	5	1.3	38	15.0	43	6.6
Total	57	14.4	70	27.7	127	19.5
Retired farmers	64	16.2	38	15.0	102	15.7
Widows of farmers	66	16.7	35	13.8	101	15.6
Nonfarmers:						
Corporations	3	.7	8	3.2	11	1.7
White collar	46	11.6	37	14.6	83	12.8
Blue collar	40	10.1	25	9.9	65	10.0
Retirees	19	4.8	17	6.7	36	5.6
Estates	30	7.6	3	1.2	33	5.1
Unknown	71	17.9	20	7.9	91	14.0
Total	209	52.7	110	43.5	319	49.2
Total	396	100.0	253	100.0	649	100.0

a/Some figures may not add due to rounding.

Prices of leased or rented quotas

The prices of leased or rented quotas varied widely. However, year-end leasing generally brought higher lease rates than leases entered into before planting. Lease rates in our sampled counties ranged from 25 cents a pound to 80 cents a pound in the flue-cured counties and from 25 cents a pound to 90 cents a pound in the burley counties. ERS has estimated that 1981 share rental rates in dollar terms averaged 39 cents a pound for flue-cured tobacco and 51 cents a pound for burley tobacco. In other cases where share renting occurred, the crop proceeds were usually evenly divided between owners and producers. The amount paid for lease or rental of a quota reduces the producer's net income.

Rights to grow tobacco, granted through the allotment and quota system, confer benefits on recipients of these rights. Since these rights can be transferred by leasing or renting, a market for rights has developed. Leasing or renting rates reflect the market value of the rights. 1/ Since most tobacco

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1/The benefits of allotment and quota rights may be shared between the owner and [illegible] of these rights. The amount shared and leasing or renting costs are negotiated by the parties involved.

growers have to lease these rights, they earn less than they would if they owned the rights and grew the same amount of tobacco.

ASCS prohibits its personnel from becoming involved in price-setting activities for leasing or renting quotas. ASCS, therefore, does not maintain information on the prices for leasing or renting quotas. In some cases producers provide this information to ASCS when notifying the agency that quotas are being transferred. However, ASCS county office employees have general knowledge of the lease and rental prices owners receive for their allotments and quotas and this was the primary basis for rental and lease cost information. Further, ERS has made projections for some rental and lease prices.

Rental costs

Rental agreements are negotiated on either a cash or share basis. When cash renting, the producer pays the owner a certain price per pound for the use of the owner's farmland and quota. Under a share rental arrangement, the owner generally furnishes the land and fertilizer while the producer supplies the labor. After the crop is marketed, both share in the sale proceeds. In our sample counties, share rental arrangements generally provided for dividing the sale proceeds evenly between owner and producer.

ERS has not developed information on cash rental rates for burley tobacco but has developed rates for flue-cured tobacco. In an October 1981 ERS report entitled "Flue-Cured Tobacco Production Costs," ERS estimated the flue-cured cash rental rate was 33 cents a pound based on data obtained in 1979. Two ERS reports entitled "Tobacco Outlook and Situation," issued in September 1981 and December 1981, estimated share rental prices in both the flue-cured and burley markets. According to the reports, the average 1981 share rental rate, stated on a dollar basis, was projected to be 51 cents a pound for burley and 39 cents a pound for flue-cured tobacco.

Lease costs

A lease agreement transferring all or part of an owner's allotment and/or quota to another farm is negotiated by the owner and the producer and is usually based on a price per pound of quota. The rates varied significantly among the counties we reviewed but were generally higher in counties with greater yields and greater concentrations of tobacco production. Year-end leasing during the 1981 marketing season generally brought higher lease rates than leases entered into before planting. This was due to a good crop yield and producers' needing quotas to market their excess tobacco.

A June 1981 ERS report entitled "Trends in Flue-Cured Tobacco Farming" contained tobacco production cost estimates based on a survey of 955 producers in the four major flue-cured tobacco regions. These regions are shown on the map on page 6. The study estimated the average lease price to be 39 cents a pound in 1979.

According to the ERS economist who wrote the report lease prices varied among regions, however, ranging from 34 cents a pound in in one region to 45 cents a pound in another.

We also found that lease rates varied widely--from 25 cents to 80 cents a pound--in our sample of flue-cured counties. For example, in early 1982 the Board of Commissioners for Pitt County, North Carolina, leased the county-held tobacco quota of 42,331 pounds for the 1982 crop year at lease rates ranging from 65 cents to 67 cents a pound. This compares with the 66 cents a pound the city of Rocky Mount, North Carolina, received at auction for its 19,000-pound quota. Conversely, lease rates of 30 cents to 35 cents a pound were reported on crop year 1981 lease agreements on file in the ASCS county offices for Lunenburg, Mecklenburg, and Pittsylvania counties in Virginia.

In May 1981 the North Carolina State University's Department of Economics and Business released a report entitled "County Lease Rates for Flue-Cured Tobacco: Revisited." The report pointed out that the average lease rate in North Carolina, which had ranged from about 13 cents to 17 cents a pound in 1966-69, had risen sharply from 27 cents in 1977 to 33 cents in 1978 and to 40 cents in 1979 and 1981.

The study pointed out that lease prices in recent years were well above prices a decade earlier but that inflation accounted for nearly all the increase. In 1979 lease rates amounted to 29 percent of the average sale price of flue-cured tobacco--the highest of any year. In 1980 lease rates declined to 26 percent of the average sale price.

In 1976 ERS developed lease rate estimates for the burley areas shown on the map on page 7. These ranged from 18 cents a pound to 28 cents a pound. However, the burley estimates had not been updated since then and we believe these rates are not representative of recent rates. For example, county executive directors in our sample burley counties told us of lease rates that ranged from 25 cents a pound in Owen County, Kentucky, to 90 cents a pound in Garrard County, Kentucky. Overall, rates reported on most leases executed before the 1981 marketing season were between 35 cents and 45 cents while most leases negotiated during the marketing months brought from 55 cents to 65 cents.

LEASING ACTIVITY IS INCREASING

ASCS leasing information showed that from 1972 to 1980 leasing activity, in terms of number of pounds leased, had increased by 55 percent for flue-cured tobacco and 180 percent for burley tobacco. In our sampled counties during 1981, as many as 83 percent of the allotment/quota owners in one flue-cured county and 33 percent of the quota owners in one burley county leased their quotas. Some of the factors influencing this leasing activity included the high cost of land with quotas, the increasing optimal scale of tobacco farms, quota reductions, and farms that no longer have tillable cropland.

Farms with allotments/quotas are expensive and not always available for sale, requiring those farmers who want to expand their operations to lease quotas from others. Furthermore, because of quota reductions, many tobacco acreage allotments have become so small, thousands of them only a fraction of an acre, that many farm owners have found it uneconomical to grow the acreage allotted. Therefore, they either lease additional quotas to maintain a viable farm operation or choose not to grow tobacco at all and lease out their quotas. Further, allotments from farms that no longer have tillable cropland are usually leased.

An April 1977 ERS report entitled "Flue-Cured Tobacco Mechanization and Labor: Impacts of Alternative Production Levels" pointed out that, economically, a tobacco farmer would lease out an allotment whenever the inputs used to produce tobacco could be reallocated to other farm and nonfarm activities and earn an income that exceeds the income from tobacco. For some farmers, the lease-out income alone may exceed the income from growing tobacco.

ASCS records do not contain enough data to determine any trend on rental activity. Agency leasing information, however, shows that the number of lease agreements is increasing. Between 1972 and 1980 the lease and transfer of allotments and/or quotas increased substantially. Flue-cured leases rose from 323 million pounds to 500 million pounds during the period, an increase of about 55 percent. However, the most dramatic change was in the burley market. In 1972, 50 million pounds were leased. The number jumped to 140 million pounds in 1980, an increase of 180 percent.

High cost of land with quotas encourages leasing

The tobacco program tends to restrict allotment ownership while encouraging leasing. In the 1970's there was a rapid trend toward mechanized harvesting of flue-cured tobacco. Mechanized harvesting systems are most profitable on intermediate- and large-sized farms, those having tobacco allotments of 15 acres or more, or about 30,000 pounds of quota. 1/ However, farms with allotments that large are rare--the average size of a flue-cured allotment is about 3 acres. An allotment and/or quota cannot be purchased without also buying the farm to which it is assigned. Therefore, acquiring enough quotas to make producing tobacco economical and profitable requires either purchasing unneeded and unwanted land or leasing quotas. Also, since larger operations

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1/According to USDA's "Agricultural Statistics 1980," the annual yield per acre of burley tobacco for the 1971-79 period averaged 2,266 pounds. For flue-cured tobacco, the comparable figure was 1,988 pounds.

are more economical, larger operators derive more benefits from allotments than do smaller operators. Thus, it can be expected that larger operators may be able to outbid smaller operators and therefore the practice of leasing increases.

According to some persons we interviewed, tobacco farmers find it difficult to buy additional farmland with an allotment and/or quota because such land is expensive. A professor from the University of Kentucky's Department of Agricultural Economics told us that the value of a farm increases $3.50 for every pound of burley tobacco quota. ASCS county office employees, bankers, and county tax office personnel told us that in the flue-cured regions a premium for the quota attached to the land could range from $2.00 to $3.50 a pound. This premium could increase the value of a farm with 8,000 pounds of quota anywhere from $16,000 to $28,000.

A North Carolina State University professor has authored several reports on the capitalization of tobacco allotments. His latest report, published in September 1981, entitled "Returns to Investors in Flue-Cured Tobacco Allotments, 1975-1980," developed separate estimates for the value per acre of farmland and the value per pound of tobacco allotment using data compiled by the Federal Land Bank in 11 flue-cured tobacco-growing counties in North Carolina. The data included information on the value of buildings and timber, acres of cropland, other land, and pounds of tobacco allotment per farm.

The study showed that cropland in these counties was more expensive and was increasing in value at a faster rate than land throughout the State. From 1974 to 1980 the value of cropland in a tobacco county had risen from $662 to $1,404 an acre, an increase of 112 percent, whereas the average value of all land in the State had increased from $551 to $885 an acre, an increase of only 61 percent.

Purchasing the allotment and/or quota on a specific farm requires purchasing the entire farm. Because the farm size is usually considerably larger than needed to grow the allotment and/or quota (for example, a 100-acre farm may have a 5-acre allotment), the purchaser ends up buying expensive land that is not needed for producing tobacco. However, farms with allotments and/or quotas are not always available for sale. As a result, the only alternative for those producers who cannot afford this expense but still want to expand their tobacco operation is to lease needed allotments and/or quotas.

Reduction of quota

The Agricultural Adjustment Act of 1938, as amended, authorizes the Secretary of Agriculture to adjust the national marketing quota for any kind of tobacco when he determines such action is necessary to maintain an adequate supply or effect an orderly reduction of onhand inventories. For 4 of the 7 crop years from 1975 through 1981, the national marketing quota for flue-cured tobacco was reduced because domestic supplies were considered excessive.

The national basic poundage quota for flue-cured tobacco was reduced from 1,491.4 million pounds for crop year 1975 to 1,012.6 million pounds for crop year 1981, or a total of 478.8 million pounds. This translates into a 32.1-percent reduction in the flue-cured quota since 1975. Since reductions in the national quota are proportioned among individual farms, their marketing quotas have also been reduced. Because of these quota reductions, many farmers have found it uneconomical to grow just their own quotas and they either lease quotas from others in order to maintain a viable farm operation or choose not to produce tobacco at all and lease out their quotas.

Allotments on flue-cured farms with no tillable cropland are usually leased

Some farms with allotments and quotas no longer have land suitable for growing tobacco. Since the owners still control the production and marketing rights assigned to their land, however, they have two options: either do nothing with the allotments/quotas or lease them out.

We identified 511 farms with tobacco allotments which had no tillable cropland in the 16 flue-cured counties we reviewed. On 81 of these farms the owners had chosen not to lease the allotments/quotas. The owners of the remaining 430 farms had leased out the production and marketing rights to 608,163 pounds of tobacco. Thus, in addition to the income they received from the alternative use of the land, owners also received income for leasing their quotas. Assuming a 39-cent-a-pound lease rate, 1/ these owners may have received additional income of about $237,000. If all 66 counties in the four flue-cured regions shown on page 6 have the same proportion of farms with no tillable cropland and a similar amount of leasing activity by quota owners, $978,000 may have been received by these owners.

U.S. TOBACCO BECOMING LESS COMPETITIVE

The high price of U.S. tobacco and the improved quality of foreign tobacco have helped cause the U.S. share of flue-cured tobacco traded on the world market to decline from 46 percent to 29 percent from 1970 to 1980. During this period U.S. use of foreign flue-cured tobacco grew from less than 2 percent to 13 percent.

The price of U.S. tobacco, based on the legislated price-support formula, is much higher than prices of foreign tobaccos.

1/This is the ERS-estimated average price for leasing flue-cured tobacco quota in 1979. (See p. 13.) Based on the information we developed, we believe the estimate is conservative.

While the high quality of U.S. tobacco has remained relatively constant and U.S. production levels have declined, foreign tobacco has increased in quantity and improved in quality.

Demand for U.S. tobacco declining

The United States has a large favorable tobacco trade balance. The Foreign Agricultural Service reported that in 1981 the total value of U.S. exports of tobacco and tobacco products exceeded imports by $2.2 billion. However, the U.S. portions of the world and U.S. flue-cured tobacco markets have declined considerably in the last decade. According to ASCS and industry officials, the decline in the U.S. share of these markets is caused primarily by two factors: (1) the rising price for U.S. tobacco and (2) the increasing quantity and improving quality of foreign tobacco.

ERS reports that in 1970 the United States had a 46-percent share of the world flue-cured tobacco trade--368 million of 797 million pounds. By 1980 the U.S. share had declined to 29 percent--391 million of 1,326 million pounds (1980 figures based on preliminary ERS data). Further, ASCS reports that U.S. imports of flue-cured tobacco have grown steadily, rising from about 10 million pounds in 1970 to 84 million pounds in 1980. During the same period, U.S. use of domestic flue-cured tobacco has decreased. As a consequence, foreign flue-cured tobacco, which made up less than 2 percent of use in 1970, made up 13 percent in 1980. The growth in imports, according to ASCS, is primarily due to the disparity in price between U.S. and foreign flue-cured tobacco.

In June 1981 the United States International Trade Commission held hearings to determine whether imported tobacco materially interferes with USDA's tobacco program. The Commission's report on its investigation, issued to the President in August 1981, concluded that presently and in the near future imports have not or are unlikely to reach a level to materially interfere with the U.S. tobacco program. However, the staff report on the Commission's study pointed out that in recent years the trend of U.S. tobacco exports, both in quantity and as a share of total world exports, has been downward. It attributed the reduction in part to the increased quantity and improved quality of foreign tobacco. It also cited as a cause the declining price competitiveness of U.S. tobacco in foreign markets due to the inflexibility of the price-support formula.

Quality of foreign tobacco improving

Officials of major U.S. and foreign cigarette manufacturers have stated that the highest quality flue-cured tobacco grown in the United States is superior to that grown in most other countries in terms of flavor, aroma, and nicotine content. This better quality tobacco currently has little difficulty attracting customers, even at high prices. However, the manufacturers state that the quality gap between U.S. and foreign tobacco is closing and that price is becoming a greater consideration. For example, Zimbabwe, a major U.S. competitor, sold its 1981 crop for a record price for that country. ERS has cited this record price as evidence of improved quality.

The staff report on the Commission's study stated that, if the demand for tobacco of similar quality to that produced in the United States is relatively insensitive to price increases, increasing competition for purchasers of lower quality tobacco coupled with rising U.S. export prices mandated by the support formula is likely to encourage further improvements in foreign tobacco quality. Thus, U.S. export markets will be increasingly threatened in the longer term.

Prices of U.S. and foreign tobacco

Although meaningful price comparisons are difficult to make because of differences in tobacco qualities, it is apparent that U.S. tobacco is the highest priced of any on the world market. In some cases the average prices received for U.S. tobacco exports were double the average prices other countries received from 1976 to 1980. Further, the support-price levels, which establish minimum prices for U.S. tobacco, exceeded the average prices of foreign tobacco exports. According to the U.S. International Trade Commission, this price differential results partially from the escalation of U.S. support prices.

Program legislation provides that price support shall be made available for each crop of any kind of tobacco for which producers have approved marketing quotas. USDA determines the support level each year in accordance with a formula in the act. USDA has no discretion to adjust the support levels for tobacco to consider world market prices as it does in establishing support levels for other commodities such as cotton and rice.

In 1960 the act was amended to adjust the support price annually from the 1959 level according to the moving average of the parity index 1/ in the 3 preceding years. Under this formula, the 1980 average support price for flue-cured tobacco was 141.5 cents a pound, compared with 66.6 cents in 1970 and 93.2 cents in 1975, while burley tobacco price supports averaged 145.9 cents in 1980, compared with 68.6 cents in 1970 and 96.1 cents in 1975.

According to USDA's Foreign Agricultural Service's estimates for 1980 the average price of exported U.S. flue-cured tobacco was $2.48 a pound compared with Zimbabwe's and Canada's average

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1/The parity index is the ratio of the general level of prices for articles and services that farmers buy for both production and family living, wages paid hired farm labor, interest on farm indebtedness secured by real estate, and taxes on farm real estate compared with the average of such prices, wages, rates, and taxes during the period January 1910 to December 1914.

export prices of 88 cents and $1.61 a pound, respectively. In the burley market, the average price of exported U.S. tobacco was $2.57 a pound in 1980 whereas Italy's and Mexico's average export prices were 98 cents and 84 cents a pound, respectively.

The following table shows the average export values of U.S. tobacco compared with those of other exporting countries as compiled by USDA's Foreign Agricultural Service.

Average Export and Reexport Value of Tobacco From Selected Exporting Countries

Country	Year 1976	1977	1978	1979	1980
	-------(dollars per pound)(note a)------				
Flue-cured:					
United States	1.85	2.03	2.25	2.35	2.48
Brazil	.71	.79	.76	1.09	1.16
Zimbabwe	.77	.86	1.02	.83	.88
Canada	1.42	1.39	1.44	1.26	1.61
Thailand	.71	.82	.74	.89	.95
Burley:					
United States	1.82	2.06	2.06	2.34	2.57
Italy	.55	.61	.77	.78	.98
Mexico	.49	.57	.61	.68	.84
Greece	1.34	.91	1.12	1.22	1.03

a/ Converted from kilograms to pounds.

The high cost of U.S. tobacco is affecting the purchasing decisions of manufacturers. Officials of a foreign manufacturer stated that because of the high cost of U.S. tobacco they are using less of it in their products. Officials of a U.S. manufacturer told us that while the company prefers to use U.S. tobacco to help maintain the consistent flavor marketed over the years, it will buy foreign flue-cured tobacco if U.S. prices continue to rise in relation to world prices. Further, officials of a U.S. export/import tobacco company told us that the U.S. tobacco industry is affected by high prices because foreign countries are looking for other sources to supply their tobacco needs.

PROGRAM'S EFFECTS ON FARM INCOME

The price-support and allotment/quota provisions of USDA's tobacco program may be adversely affecting farm income. High tobacco support prices have contributed to the decreased U.S. share of world exports and the increase in U.S. imports. Because of the lower demand for some U.S. flue-cured tobacco, the amount of quota that farmers can market has been reduced. Therefore, while the high prices assured under the price-support provision may have increased per-pound income, total income may not have increased because of reduced quotas resulting from lost foreign and domestic markets. This would, of course, depend on how responsive tobacco purchasers were to price increases.

The increased quantity and improved quality of less expensive foreign flue-cured tobacco is reducing the market share of U.S. flue-cured tobacco. This has caused the U.S. share of the world flue-cured market to decline. Further, the lower priced imports have displaced lower quality U.S. flue-cured tobacco. For example, foreign tobacco from lower positions on the stalk, used primarily for cigarette filler, is of satisfactory quality for that purpose. U.S. tobacco of the same quality is not competitive at the support-price levels and is usually taken under loan by CCC.

To prevent the accumulation of excessive amounts of tobacco, the Secretary has the authority to reduce acreage allotments and marketing quotas. As the quotas are reduced, however, some farmers with marginal-sized operations find it uneconomical to grow their quotas. Also, with the declining competitiveness of domestic tobacco, other U.S. farmers ultimately could lose income because high prices will continue to reduce demand at home and abroad for U.S. tobacco, resulting in further cuts in quota.

According to the staff report of the U.S. International Trade Commission's study, U.S. export markets will be increasingly threatened in the long term as purchasers increasingly compete for less expensive, lower quality tobacco. In addition, purchasers of U.S. tobacco must agree to pay an amount at least equal to the support price. Therefore, the higher the support price and the resulting selling price in relation to the price of foreign tobacco, the less competitive U.S. tobacco will be in world markets.

SECRETARY OF AGRICULTURE'S ACTION TO IMPROVE THE PROGRAM

The Agriculture and Food Act of 1981 (Public Law 97-98) stated the intent of the Congress that

> "* * *the tobacco price support and production adjustment program be carried out in such a manner as to result in no net cost to the taxpayers other than such administrative expense as is incidental to the implementation of any commodity program."

The Secretary was directed to recommend to the Congress by January 1982 any legislative changes he believed were necessary to achieve this objective.

In his January 1982 report to the Congress, the Secretary acknowledged that despite marketing quotas and acreage allotments, which substantially limit loan activity, the current high support level means that even a modest amount of tobacco coming under loan would require considerable loan outlays. Therefore, the Secretary asked the Congress for legislative authority to adjust the price-support levels for the various kinds of tobacco.

The Secretary said that the legislated formula had increased the price of tobacco without regard to changes in production costs and the prices of competing countries. According to the report:

--The support levels for each kind of tobacco increased 129 percent from 1971 to 1981.

--Since the present formula was enacted in 1960, the U.S. share of world tobacco exports has declined from 30 percent to 21 percent.

--Flue-cured and burley tobacco imports have increased from a negligible amount to about 15 percent of domestic use.

CONCLUSIONS

Active tobacco farmers, once the program's intended beneficiaries, now constitute a minority of allotment and quota owners. During the past decade leasing activity by owners, which USDA originally estimated would be minimal, has increased significantly. Today, most owners do not grow tobacco but lease or rent out the production and marketing rights.

U.S. tobacco is the highest priced of any on the world market. The high prices of U.S. tobacco and the improved quality and increased production of foreign tobacco have caused the U.S. share of world tobacco exports to decline while U.S. imports of foreign tobacco have increased.

Acreage allotments, marketing quotas, and price supports contribute to the high prices for domestic tobacco. Allotments and quotas increase prices by restricting the available supply. Price supports raise prices by setting a floor price below which no farmer would sell tobacco in the open market. This floor price for U.S. tobacco is above the price of foreign tobacco. Therefore, purchasers of U.S. tobacco must be willing to pay at least the support price.

Reductions in the markets for U.S. flue-cured tobacco resulted in reductions in individual farm quotas in 4 of the 7 crop years from 1975 through 1981. Therefore, although tobacco prices increased during the period, the impact on producer income because of quota reductions may not have been positive.

If the price for U.S. flue-cured tobacco continues to stay above the prices for imported tobacco, imports will in all likelihood assume an even greater share of total U.S. use of flue-cured tobacco. Low-quality flue-cured tobacco has been affected by foreign competition. Authorizing the Secretary to adjust the price-support levels for the various kinds of tobacco could make U.S. flue-cured tobacco more competitive in domestic and foreign markets and help curtail the amounts of low-quality U.S. flue-cured tobacco coming under loan to CCC.

CHAPTER 3

INFORMATION ON PROGRAM COSTS

The Government incurs administrative and interest costs as well as losses in operating the tobacco program. Since the 1930's $57 million has been lost disposing of CCC loan stock tobacco. (CCC still has loans outstanding for crop years 1975-81.) Administrative costs were estimated to be $13.1 million in fiscal year 1981. More significant, however, are the large losses CCC has incurred making loans at below-market interest rates and allowing loan repayments from sale proceeds to be applied first to the principal amount outstanding rather than to accrued interest.

PROGRAM COSTS

Considerable concern has been expressed about the cost the Government incurs operating the tobacco program. As a result of this concern, we obtained information on program administrative and interest costs as well as losses which have occurred from disposing of CCC loan stock tobacco.

Total administrative costs for the tobacco program cannot be determined

ASCS does not maintain records on the exact costs to administer the tobacco program but estimates the costs to be $13.1 million for fiscal year 1981. It has also estimated that such costs will be $14.6 million for fiscal year 1982 and $15.9 million for fiscal year 1983.

ASCS' cost estimates are based on the time it takes for a sample of county employees to oversee the program's day-to-day operation. In addition to these costs, however, other administrative costs are incurred but not reported as supporting the program. These costs relate to overseeing loan activity, maintaining basic farm records, and conducting county committee elections.

CCC could incur losses on low-quality flue-cured stocks

For the crop year stocks already sold through September 30, 1981, $57 million in loan principal was not recovered, resulting in losses to CCC. The flue-cured tobacco now under CCC loan is made up mostly of less desirable grades from the 1975-80 crop years. This tobacco will have to be sold before it begins to deteriorate, however, and price discounts will likely be needed, resulting in additional CCC loan losses. USDA has taken action to help prevent the continued buildup of low-quality tobacco in CCC loan stocks.

As of December 1981 flue-cured loans outstanding for the 1975-80 crop years totaled $640 million. ASCS states that because of competition from imports, loan inventories have shifted mostly to less desirable grades which cannot be sold readily since they are relatively high priced compared with foreign tobacco of comparable quality. As it becomes necessary to sell tobacco under loan before it deteriorates, price discounts may be needed. If discounts are made, the entire loan value will not be recovered and CCC will realize losses.

USDA has taken steps to decrease the flue-cured stocks. One was reducing the national flue-cured marketing quota 4 of 7 years from 1975 through 1981, as discussed on page 16. Another is the 4-Leaf Program initiated in 1978. Under this program growers are allowed to plant up to 120 percent of the farm acreage allotment and still receive price support if they agree not to harvest the four lower leaves on each stalk. The leaves on the lower stalk (normally about one-third of a flue-cured crop) generally lack the aroma and flavor manufacturers desire. This program enables farmers to produce and market more of their poundage quota in higher value, upper stalk tobacco and less of their quota in lower stalk tobacco for which demand and prices are lower.

CCC is losing money on interest payments for tobacco program loans

In a January 11, 1982, letter report to CCC's Executive Vice President entitled "Collection and Accounting for Accrued Interest on Commodity Credit Corporation Producer Loans" (AFMD-82-40), we discussed how CCC repayment practices, initiated in 1966, understate interest costs on tobacco loans. Cash received from loan repayments is applied first to loan principal and then, after the principal is liquidated, to interest receivable. This procedure is inconsistent with CCC's procedures for repaying its Treasury borrowings and with normal banking procedures.

The Treasury charges CCC interest on the daily outstanding balance owed, which includes unpaid interest on borrowings from prior periods. In contrast, the tobacco producer associations pay interest to CCC on the daily outstanding principal balances, which do not include interest from prior periods. Thus, the associations pay interest at substantially reduced amounts because their loan principal balances are more rapidly reduced as they apply sale proceeds first to loan principal, until liquidated, and then to accrued interest. As a result, a significant difference exists between the amounts of interest recorded and collected on CCC tobacco loans and the corresponding interest which CCC pays the Treasury for borrowed funds.

For example, using data for only the loans on CCC tobacco stocks from crop years 1978-80, we calculated that the present practice cost CCC almost $2 million in fiscal year 1980 alone. Had we calculated the costs for all tobacco crops under loan in all the years since 1966, the amount would have been much larger. This lost revenue benefits the tobacco producer associations in the form of reduced interest payments. In our January 11, 1982, report, we recommended that CCC bring its loan repayment practices more in line with the method it follows for its Treasury borrowings. As of April 1, 1982, CCC had not acted on the recommendation.

In addition to losing revenues through repayment practices, CCC has lost and continues to lose money on loans having lower-than-market interest rates. Since April 1981 tobacco price-support loans have been made at the same interest rates charged by the U.S. Treasury. The interest rates on these loans also are adjusted to the Treasury rate each January 1 thereafter. In December 1981 the Treasury charged CCC 14.5 percent. However, loans on tobacco from prior crop years continue to benefit from below-market interest rates ranging from 6 percent to 11.5 percent. The interest rates on these loans are fixed and were lower than the Treasury's rates at the time the loans were made. As of December 1981 interest accrued at these below-market rates on the 1975-80 flue-cured tobacco loan stocks amounted to about $243 million. However, interest charges would have been much higher had USDA periodically adjusted the interest rates as it has for loans made after April 1, 1981.

ASCS and CCC officials calculated that the amount of interest CCC has paid to the Treasury from inception of the program through September 30, 1980, could total about $845 million, while CCC records indicated that it had collected $254 million in interest income, or a net loss to the Government of about $591 million. CCC's Comptroller said that CCC could not attest to the figures because the interest expense was based on yearly beginning and ending average loan balances and the interest income was based on documentation which probably was incomplete.

CONCLUSIONS

The tobacco price-support program has incurred substantial unreported interest cost expenses. Losses estimated at $591 million have occurred and additional losses can be expected on loans that were made at below-market interest rates before April 1981. Since April 1981, tobacco price-support loans have been made at the same interest rate charged by the Treasury.

Additional losses have occurred and continue to occur because of CCC loan repayment practices, which allow sale proceeds to be applied first to loan principal and then to accrued interest. These practices, which we earlier recommended be changed, are inconsistent with CCC's procedures for repaying its Treasury borrowings and with normal banking practices.

CHAPTER 4

MARKETINGS OF WAREHOUSE FLOOR SWEEPINGS

The warehouse floor sweepings allowance permits warehouses to gather and resell tobacco which has fallen off already sold auctioned lots. In the warehouses we visited, most of the floor sweepings tobacco brought prices approaching the average market price producers received. ASCS, AMS, and OIG officials believe that because floor sweepings are leaves or bits of tobacco, they should not be top quality tobacco; therefore, a lower price would have been expected.

FLOOR SWEEPINGS GENERALLY BRING HIGH PRICES

The floor sweepings allowance permits some tobacco that has fallen off producer lots to be gathered from the auction floor and sold by the warehouse for its own profit. According to ASCS, AMS, and OIG officials and a tobacco manufacturer, floor sweepings tobacco should bring lower-than-average prices because it is a mixture of leaves and bits of tobacco. Our review of six flue-cured and six burley warehouses, however, showed that floor sweepings generally were sold at prices that approached the average market price of all tobacco sold.

The floor sweepings allowance

USDA regulations establish a floor sweepings allowance that enables warehouses to market tobacco scraps or leaves left on the floor after an auction sale has been completed. Thus, this tobacco, which already has been sold once by the producers to dealers and manufacturers, can be gathered from the warehouse floor and resold, possibly to the same dealers--this time for warehouse profit.

Producers deliver tobacco to the warehouses in lots that are either tied, baled, or in burlap sheets. The lots are weighed, graded, and set out on the warehouse floor for auction sale and then graded by an AMS inspector. Once the tobacco is sold, the loose leaves in the immediate vicinity are put back on the lot and it is moved to another section of the warehouse. Warehouse employees pick through any remaining tobacco and select the best leaves or bits which the warehouse then displays on the auction floor for sale as floor sweepings.

USDA limits the amount of floor sweepings that warehouses can legally market to a certain percentage of total producer sales. The size of the allowance varies by type of tobacco--0.5 percent for flue-cured and 0.24 percent for burley.

Floor sweepings sold at prices comparable to producer sale prices

We reviewed floor sweepings sales for the 1981-82 marketing year at six flue-cured warehouses and six burley warehouses. We selected the warehouses on the basis of the percentage of the floor sweepings allowance they had actually marketed during the 1980 marketing year. Two had marketed a small portion; five, a moderate portion; and five, most of or more than their allowance.

Several State ASCS officials in North Carolina said that most floor sweepings should be tobacco that has been trampled on the auction floor, resulting in dirty, broken leaves of tobacco that would bring low sale prices. An OIG official told us that floor sweepings should consist of a wide variety of tobacco types, textures, and colors with a relatively high content of fragmented leaves and trash. He said that even after cleaning the tobacco, a warehouse normally would not be able to produce pile after pile of high-quality tobacco capable of receiving consistent grades.

An official from AMS, which has responsibility for inspecting and grading tobacco, questioned whether floor sweepings could be of top quality because of the way this tobacco is collected. He said that tobacco grades vary tremendously from scrap tobacco to top grades. A tobacco manufacturer also agreed that floor sweepings normally should not be top quality tobacco. However, our review showed that most floor sweepings marketed brought prices approaching the average market price paid for producer first-sale tobacco.

The prices for floor sweepings at the six flue-cured warehouses ($1.41 to $1.69 a pound) were slightly below the average market prices ($1.60 to $1.72 a pound) received by producers at those markets. However, on numerous days during the marketing year, some warehouses received prices for floor sweepings that were higher than the average prices producers received. For example, on August 13, 1981, one warehouse in Granville County, North Carolina, received $1.76 a pound for floor sweepings when the average market price that day was $1.55 a pound. On August 27, 1981, a warehouse in Durham County, North Carolina, received $1.75 a pound for floor sweepings when the average market price that day was $1.63 a pound.

The prices of the floor sweepings sold at auction at the burley warehouses we selected ranged from $1.53 to $1.80 a pound, while nonauction floor sweepings sold for 27 cents to 45 cents a pound. The prices of the auctioned floor sweepings were only slightly less than the average prices producers received, which ranged from $1.79 to $1.82 a pound.

The following table gives a general indication of the prices received for floor sweepings compared with the average market prices at the 12 warehouses we reviewed.

Summary of Selected
1981 Warehouse Floor Sweepings Sales

Ware-house	Portion of allowance marketed	Floor sweepings: Pounds marketed	Floor sweepings: Average price	Average market price
			(dollars per lb.)	
Flue-cured:				
A	Small	564	$1.44	$1.66
B	Medium	7,268	1.41	1.71
C	"	13,556	1.45	1.64
D	Large	8,396	1.60	1.64
E	"	40,160	1.69	1.72
F	"	41,472	1.46	1.60
Burley:				
A	Small	1,824	a/0.30	1.82
B	Medium	3,498	1.80	1.82
C	"	9,340	1.76	1.80
D	"	5,918	a/0.27	1.79
E	Large	5,101	a/0.45	1.80
	"	3,660	1.53	"
F	"	2,608	1.70	1.82

a/Denotes a nonauction sale of floor sweepings. These are sales of scrap tobacco that contain trash such as rocks, bottles, and string.

Warehouse receipts from floor sweepings sales are profit, except for the costs incurred in gathering the tobacco and preparing it for sale. According to State ASCS officials in North Carolina, if 1 billion pounds of flue-cured tobacco are marketed for the 1981 marketing year, floor sweeping sales could amount to $8 million.

CONCLUSIONS

Some USDA officials and a tobacco manufacturer told us that they believe that low prices would have been expected for floor sweepings tobacco. Our review disclosed, however, that floor sweepings generally were sold at prices that approach average market prices.

USDA FLUE-CURED TOBACCO REGIONS SELECTED FOR REVIEW

State/County	Number of farms	Effective quota
		(1,000 lbs.)
Region 17		
North Carolina		
Edgecombe*	1,457	17,571
Franklin	2,710	15,493
Greene*	1,248	18,830
Harnett	3,454	22,988
Johnston*	5,411	35,211
Lee	1,285	5,707
Lenoir	1,934	22,930
Nash	2,895	27,153
Pitt*	2,456	38,937
Sampson*	5,072	23,815
Wake*	3,899	27,949
Warren	1,804	7,444
Wayne	3,067	23,453
Wilson	2,096	26,249
Total	38,788	313,730
Region 18		
Virginia		
Brunswick	1,708	6,747
Charlotte	1,148	4,405
Franklin	1,094	3,879
Halifax	3,673	18,795
Henry	562	1,615
Lunenburg*	1,158	5,908
Mecklenburg*	2,341	12,784
Patrick	982	2,895
Pittsylvania*	3,879	25,644
North Carolina		
Alamance	1,513	6,537
Caswell*	1,957	12,765
Durham*	879	4,652
Forsyth	2,156	7,536
Granville*	2,193	17,965
Guilford	3,280	13,198
Orange	1,085	4,793
Person*	1,821	13,598
Region 18 (Cont.)		
Rockingham*	3,067	18,634
Stokes	2,972	15,814
Surry*	3,186	15,992
Vance*	1,475	10,701
Yadkin	3,024	11,251
Total	45,153	236,109
Total for regions 17 and 18	83,941	549,838

*Indicates counties selected for review.

USDA BURLEY TOBACCO AREAS SELECTED FOR REVIEW

State/County	Number of farms	Effective quota
		(1,000 lbs.)
Area 1		
Kentucky		
Bourbon*	1,358	10,849
Clark	1,630	6,780
Fayette	1,481	11,484
Jessamine	1,479	6,439
Mercer*	1,651	6,677
Scott	1,590	9,434
Woodford*	1,090	9,621
Total	10,279	61,284
Area 2		
Kentucky		
Anderson	1,272	3,223
Bracken*	1,047	5,973
Carroll	602	3,440
Franklin	1,233	5,394
Gallatin	543	2,006
Grant	1,759	5,332
Harrison	1,629	8,481
Nicholas	909	5,129
Owen*	1,402	7,140
Pendleton	1,455	4,651
Robertson	453	2,328
Total	12,304	53,098
Area 3		
Kentucky		
Bath*	1,177	5,892
Boyle	1,156	4,459
Fleming	1,691	6,944
Garrard*	1,455	6,815
Henry	1,489	8,634
Madison*	2,235	10,192
Marion	1,441	4,917
Mason	1,169	8,038
Montgomery	1,223	6,181
Nelson	1,853	4,350
Area 3 (Cont.)		
Oldham	648	1,630
Shelby	2,290	10,585
Spencer*	891	3,844
Trimble*	794	3,525
Washington	1,535	6,228
Total	21,047	92,234
Area 4		
Kentucky		
Adair	2,563	4,310
Allen	2,041	3,280
Casey	2,643	5,433
Clinton	1,502	2,211
Cumberland*	1,181	2,373
Green	1,772	5,359
Lincoln	2,422	6,126
Monroe*	1,785	3,410
Pulaski*	4,076	6,178
Russell*	2,077	3,182
Taylor*	1,754	4,587
Wayne	1,941	2,935
Tennessee		
Clay	1,082	1,391
Jackson	1,741	2,236
Macon*	2,233	4,077
Pickett	859	951
Total	31,672	58,039
Total for areas 1, 2, 3, and 4	75,302	264,655

*Indicates counties selected for review.

PROJECTIONS OF FARMS AND QUOTA USE

IN USDA AGRICULTURAL REGIONS AND AREAS SELECTED FOR REVIEW (notes a and b)

Use of basic quota	Burley areas: Number of farms	%	Pounds of Basic quota (100,000)	%	Flue-cured regions: Number of farms	%	Pounds of Basic quota (100,000)	%
Farms not leasing at all:								
Renting	16,349	21.7	1012.6	39.7	18,515	22.1	2082.1	38.2
Relative growing	4,454	5.9	92.0	3.6	2,279	2.7	253.1	4.6
Owner growing	32,495	43.2	1002.3	39.3	9,996	11.9	762.3	14.0
Total	53,298	70.8	2106.9	82.6	30,790	36.7	3097.5	56.8
Farms leasing some quota but not all (note c):								
Renting	1,276	1.7	57.3	2.3	1,655	2.0	173.8	3.2
Relative growing	222	.3	7.5	.3	183	.2	35.7	.7
Owner growing	1,240	1.6	43.8	1.7	3,867	4.6	309.8	5.7
Total	2,738	3.6	108.6	4.3	5,705	6.8	519.3	9.5
Farms leasing out all quota	19,265	25.6	336.4	13.2	47,445	56.5	1836.5	33.7
Total	75,302	100.0	2551.8	100.0	83,941	100.0	5453.3	100.0

a/Some figures may not add due to rounding.

b/The total number of farms in the sample projection equals the actual number of farms in the selected regions and areas because the sample farms were weighted proportionally to the number of farms in the county. The total basic quota figure from our sample, on the other hand, is slightly different from the actual total basic quota because of this weighting procedure.

c/Includes some farms that leased out an amount equal to or greater than the basic quota but still have an effective quota from a previous year's adjustment or from quotas leased in.

CATEGORIZATION OF ALL ALLOTMENT AND QUOTA OWNERS INCLUDED IN SAMPLE (note a)

	Flue-cured		Burley		Combined	
	Number	Percent	Number	Percent	Number	Percent
Farmers:						
Full-time	101	21.0	171	35.6	272	28.3
Part-time	16	3.3	97	20.2	113	11.8
Total	117	24.3	268	55.8	385	40.1
Retired farmers	67	14.0	47	9.8	114	11.9
Widows of farmers	75	15.6	47	9.8	122	12.7
Nonfarmers:						
Corporations (note b)	3	.6	8	1.7	11	1.1
White collar (note c)	50	10.4	37	7.7	87	9.1
Blue collar (note d)	41	8.6	28	5.8	69	7.2
Retired	19	4.0	21	4.4	40	4.2
Estates	33	6.9	3	.6	36	3.7
Unknown	75	15.6	21	4.4	96	10.0
Total	221	46.1	118	24.6	339	35.3
Total	480	100.0	480	100.0	960	100.0

a/Some figures may not add due to rounding.

b/Included in this category were entities such as private company-, church-, and court-held property.

c/Included in this category were occupations such as doctor, lawyer, warehouse operator, dentist, city manager, realtor, corporation executive, and government employee.

d/Included in this category were occupations such as printer, truck driver, construction worker, roofer, storekeeper, electrician, welder, and grocery store employee.

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