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REPORT BY THE

Comptroller General

OF THE UNITED STATES

Department Of Agriculture And Producer Costs To Operate The Tobacco Program

For 1983, the Department of Agriculture regulated the production and marketing of eight kinds of tobacco, including the two primary kinds--flue-cured and burley--through acreage allotments, marketing quotas, and price-support loans. While the No Net Cost Tobacco Program Act of 1982 generally provides that this program be carried out at no net cost to the taxpayers, it does not require the Department of Agriculture to recover all of the interest cost incurred.

GAO found that the tobacco program will continue to operate at a loss to the government unless the method for charging interest on the tobacco price-support loans is changed. The Secretary of Agriculture has not implemented a prior GAO recommendation to recover these costs. Accordingly, GAO recommends that if the Congress intends to include full interest costs among those costs to be recovered from producers, the 1982 act be amended to require that the Department of Agriculture's Commodity Credit Corporation recover full interest costs.

UNITED STATES GENERAL ACCOUNTING OFFICE

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FEBRUARY 8, 1985

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

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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 February 9, 1983, letter, this report summarizes the results of our review of the federal government's no net cost tobacco program. We made this review to determine whether the program operates at no net cost to the government.

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of Agriculture; various Senate and House committees; members of Congress; and other interested parties.

Charles A. Bowsher
Comptroller General
of the United States

COMPTROLLER GENERAL'S REPORT

DEPARTMENT OF AGRICULTURE AND PRODUCER COSTS TO OPERATE THE TOBACCO PROGRAM

D I G E S T

The Department of Agriculture, under the authority of the Agricultural Adjustment Act of 1938 (the "1938 act") (7 U.S.C. §1281 et seq.), administers a program that regulates tobacco production and supports tobacco prices through acreage allotments (acres planted) and marketing quotas (pounds marketed) to stabilize prices and protect farmers' income. The program limits the amount of tobacco that can be produced and sold, and ensures producers a minimum price for their tobacco. (See p. 1.)

Allotments and/or quotas are assigned to a particular farm and only those farms with an allotment and/or quota can market tobacco. An owner of a farm's allotment and/or quota may (1) produce the quota, (2) sell the allotment and/or quota, (3) rent the quota for production on the owner's farm, or (4) by use of a lease, transfer part or all of the farm's allotment and/or quota to another farm within the same county. Farms participating in the allotment and/or quota programs 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 the Department. (See p. 2.)

The 1938 act specifies that for the Department to establish and regulate a marketing quota and acreage allotment program for an individual kind of tobacco, the program must be approved every 3 years in a referendum by at least two-thirds (or for some tobaccos, at least one-half) of the producers voting. For the 1983 crop year,[1] producers approved individual programs for eight kinds of tobacco, including the two primary kinds, flue-cured and burley. (See p. 2.)

The program's administrative expenses are funded through the Department of Agriculture's appropriations and the program's price-support operations through government borrowings. The

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[1]A crop year is the year in which a crop is normally harvested.

Department estimates that administrative expenses were $41.5 million for fiscal years 1982 through 1984. In carrying out the price-support functions, the Department's Commodity Credit Corporation borrows funds from the U.S. Treasury to provide price-support loans to tobacco producer associations.[2] The associations, in turn, use the funds to make cash advances to tobacco producers unable to sell their tobacco for at least the government support rate (the minimum price per pound) assigned to individual grades of tobacco.

Cash advances are made in the form of loans to producers. However, the loans--called nonrecourse loans--limit the liability of the producer for repayment of the loan to the value of the loan's collateral, in this case the tobacco under loan. This means that the producer would not be liable for losses which could be incurred by the association in the event that the proceeds from the sale of the tobacco under loan by the association do not recover the full principal and interest costs of the loan. When the tobacco is sold, the proceeds are used by the associations to pay for the program costs, including the repayment of loan principal and interest to the Commodity Credit Corporation. (See pp. 1, 2, and 7.)

For 1981 and prior crop years, the government paid for the program's administrative costs as well as for any losses incurred by the producer associations as a result of the price-support program. However, the No Net Cost Tobacco Program Act of 1982 (Public Law 97-218, July 20, 1982) (the "1982 act"), which amended the Agricultural Adjustment Act of 1938 (7 U.S.C. §1281 *et seq.*) and the Agricultural Act of 1949 (7 U.S.C. §1421 *et seq.*), made significant changes to the program for 1982 and subsequent crop years.

The 1982 act generally provides that the program be carried out at no net loss to the taxpayer,

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[2]The Department contracts with 13 producer associations to administer the tobacco price-support program. The associations handle all program operations related to making cash advances to producers and receiving, processing, storing, and eventually selling the loan stock tobacco.

other than for the Department's administrative expenses. Under the 1982 act, producers of each kind of tobacco for which a price-support program is in effect are assessed an annual fee on each pound of tobacco marketed. This fee, which can vary from year to year and from tobacco to tobacco, is deposited into an account or fund and is to be used to pay for losses incurred by the producer associations in administering the loan program. These losses usually occur when tobacco sales revenues are insufficient to cover an association's program expenses, including the repayment of price-support loan principal and interest. (See pp. 4 and 5.)

The Chairman, Senate Appropriations Committee, and the Ranking Minority Member of that Committee's Subcommittee on Agriculture, Rural Development, and Related Agencies, asked GAO to provide information on (1) whether the program operates at no net cost to the government, (2) whether the assessments required of tobacco producers are sufficient to meet possible losses in stored tobacco purchased through government loans, (3) the extent to which active tobacco farmers have purchased allotments and/or quotas and whether leasing has diminished, (4) alleged voting irregularities in the 1982 flue-cured tobacco referendum approving a flue-cured tobacco price-support program, and (5) the actual value of tobacco stored by producer associations and what percentage is likely to be lost to deterioration over the next 5 years. GAO focused its review on the two primary kinds of tobacco--flue-cured and burley. (See p. 1 and app. I.)

GOVERNMENT INCURS INTEREST COSTS WHICH ARE NOT RECOVERED

Because the Commodity Credit Corporation does not recover full interest costs on loans to producer associations, the tobacco price-support program will continue to operate at a loss to the government unless the method the Corporation uses to charge interest is changed. (See p. 7.)

Interest on funds the Corporation borrows from the Treasury to make loans to tobacco associations is compounded semiannually. In contrast, the Corporation does not compound accrued interest on any of the loans it makes to the associations. GAO estimates that because of this difference, interest due the Corporation on the 1982 flue-cured crop was understated by $6 million for the first 2 years (July 1982-June 1984) that the crop was under loan. Further, because loan payments are made only as an association sells the tobacco, interest will continue to accrue on some portion of the borrowed funds as long as any part of the crop remains unsold. (See pp. 9 and 10.)

Although GAO estimated understated interest for only a 2-year period, the Department's Office of Inspector General estimated that the Corporation could lose about $164 million on the 1982 flue-cured crop under loan. In making this projection, the Inspector General estimated that portions of the 1982 flue-cured crop would not be sold for 8-1/2 years. Unless the Corporation changes its interest computation procedure to compound interest, understated interest costs will increase each year as the Corporation's procedure applies to all tobacco under loan and understated interest costs will occur each year for each kind of tobacco under loan. (See pp. 10 and 11.)

In a prior report,[3] GAO recommended that the Corporation bring its interest computation practices more in line with the method it follows for its Treasury borrowings. The recommendation was not implemented. (See p. 9.)

In analyzing the 1982 act and its legislative history, GAO found an apparent contradiction between the goals of the act, its provisions, and elements of its legislative history. The goal expressed by the Congress in the 1982 act was to achieve a tobacco program that operates at no net cost to the taxpayers. The House and Senate reports, along with numerous statements from the floor debate, echoed the no net cost objective of the 1982 act. However, the statements in the House and Senate debate discussing the Corporation's procedures which result in interest losses show that the Congress had been advised that the Corporation's procedures were a continuing source of losses to the tobacco program and that the provisions of the act did not directly address the issue. (See p. 8.)

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[3] Collection and Accounting for Accrued Interest on Commodity Credit Corporation Producer Loans (AFMD-82-40, Jan. 11, 1982).

Although the 1982 act does not require the Corporation to change its procedures for charging interest, GAO believes that the action it recommended, that the Corporation's procedures be changed to conform to the procedures it follows on its loans from the Treasury, would further the act's basic purpose of creating a no net cost tobacco program and be consistent with sound management principles of cost recovery. (See p. 8.)

GAO also notes that the Secretary of Agriculture has the discretionary statutory authority to implement such a change but has not done so. On December 1, 1983, the Corporation's executive vice president stated that any substantive change in the procedures the Corporation uses with respect to charging and crediting interest under the tobacco price-support program would alter the program in a manner not contemplated in the 1982 act. He also stated that full recovery of interest costs would require a 160-percent increase in producer assessment fees and would result in destruction of the tobacco price-support program. (See pp. 8 and 9.)

Obtaining full recovery of interest costs by the Corporation might be a contributing factor in producers' deciding not to participate in the program. According to a tobacco program official, the 160-percent increase referred to by the executive vice president would amount to 5 cents per pound. Although this increase would be small (about 4 percent) in relation to the cost of producing tobacco (about $1.16 per pound for flue-cured tobacco in 1983), GAO does not know whether the future costs of the program might outweigh its benefits to the producers and thus encourage them not to participate in the program.

The program presently limits the amount of tobacco that can be marketed and, in 1983, guaranteed flue-cured tobacco producers an average loan rate of $1.70 per pound of tobacco. The program also allows individual owners of allotments to sell, rent, or lease them to tobacco growers. The average rental value of quotas/allotments in 1983 was about 44 cents a pound. If this program was discontinued as a result of producers' voting not to participate any longer, they would be free to produce as much tobacco as they wanted, but they would not have any price guarantees, nor would they have allotments/quotas to sell, rent, or lease. (See p. 11.)

Recommendation to the Congress

GAO recommends that if the Congress wants to ensure no costs to the taxpayer, it amend the No Net Cost Tobacco Program Act of 1982. This amendment should require that the amount of payments on principal and interest that tobacco producer associations pay on price-support loans equals the amount of payments on principal and interest that the Corporation pays the Treasury for borrowed funds. (See p. 13.)

ADEQUACY OF THE ANNUAL ASSESSMENT FEE

As required by the 1982 act, producers of each kind of tobacco for which a price-support program is in effect are assessed a Department-approved annual fee on each pound of tobacco marketed to cover the anticipated financial losses of the tobacco price-support program. For crop year 1982, the flue-cured assessment was 3 cents per pound, and the burley assessment was 1 cent per pound. These assessments generated revenues of $29.5 million and $7.5 million, respectively. (See p. 14.)

According to a July 27, 1983, Department report, the associations purchased more price-support tobacco than anticipated and the initial Department-approved assessments were inadequate to ensure a no net cost program for the 1982 crops, as an additional $60.5 million for the flue-cured crop and $112.5 million for the burley crop would be needed to recover costs. Under the program, however, producer assessments in future years are to be increased if earlier years' assessments are inadequate to cover costs.

To collect the flue-cured shortage, the Department increased the 1983 and 1984 assessments by 4 cents and 2 cents, respectively. Subsequent to the July 1983 report, the $112.5 million shortfall in the burley program was eliminated when tobacco purchasers, anticipating that the drought-ridden 1983 burley crop would be of poor quality, purchased 116 million pounds of crop year 1982 burley tobacco from the producer association. Department officials said that as a result of these purchases, the 1982 assessment should be adequate to cover crop year 1982 burley program costs. (See pp. 14 to 16.)

As discussed in the previous section, producer assessment fees would have to be increased if the Department changed its procedures for charging interest to fully recover interest costs on producer loans to associations. (See p. 16.)

SALES AND LEASES OF TOBACCO ALLOTMENTS/QUOTAS

Prior to the 1982 act, flue-cured or burley tobacco allotments and/or quotas could be leased but not sold without also selling the farmland. The act revised this procedure to allow flue-cured allotment and quota owners to sell their allotments and quotas without having to sell farmland. A 1983 amendment also allowed some burley quota owners to sell their quotas. As of May 24, 1984, quotas for about 17.4 million pounds of flue-cured tobacco, representing about 2 percent of the 1983 quota, and quotas for about 43,000 pounds of burley tobacco, representing about 1 percent of the 1983 quota, had been sold. (See pp. 19 and 20.)

The amounts of flue-cured and burley quotas leased in crop year 1983 decreased from the amounts leased in crop year 1982. Flue-cured tobacco leases decreased by about 29 percent--from about 465 million pounds in crop year 1982 to about 329 million pounds in crop year 1983; and burley tobacco leases decreased by about 11 percent--from about 185 million pounds to about 165 million pounds during the same period. Department officials cited the following reasons that farms decreased their 1983 leasing: a reduction in the total tobacco quota in 1983, sales of flue-cured allotments/quotas, and increased use of rent arrangements.[4] (See pp. 17 to 19.)

VOTER REFERENDUM

Referendums generally are held every 3 years to determine whether allotment and/or quota holders

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[4]In a rental situation, the producer grows the tobacco on the owner's farm whereas in a leasing situation, the tobacco is grown on another farm in the same county.

for each kind of tobacco want a government acreage allotment and marketing program to be in effect for a 3-year period. A quota program must be approved by producers before the Corporation will make a price-support program available. The referendum for flue-cured and burley tobaccos must be approved by at least two-thirds of the producers voting before a program can be instituted or continued. The latest referendum for flue-cured tobacco was in December 1982 and resulted in a 93.7 percent approval rate.

A Department inquiry into alleged voting irregularities in five North Carolina counties during the December 1982 referendum disclosed that some voters were apparently ineligible. Each voter's eligibility was not thoroughly investigated because of the time and expense involved. However, elimination of all the alleged ineligible votes would have decreased the percentage of votes favoring a program from 93.2 percent to 89.3 percent in the five counties. Thus, program officials believe that the irregularities did not have any overall effect on the referendum results. (See pp. 21 and 22.)

VALUE OF TOBACCO UNDER LOAN AND EXTENT OF ITS DETERIORATION

As of December 31, 1983, about 734 million pounds of flue-cured tobacco valued at $1.7 billion and about 189 million pounds of burley tobacco valued at about $544 million were being stored by tobacco associations under the Department's price-support loan program. The flue-cured tobacco was from crop years 1975-83; the burley, from crop years 1981-83.

Flue-cured and burley tobacco, if properly stored, is usable for many years. Tobacco specialists contacted by GAO stated that there is no known specific deterioration rate for stored tobacco. The consensus of the tobacco specialists was that the quality generally improves for the first 2 or 3 years, after which the quality slowly declines. Consequently, how much stored tobacco will be lost to deterioration is unknown. (See pp. 23 and 24.)

AGENCY COMMENTS

In commenting on a draft of this report, the Acting Administrator of the Department's Agricultural Stabilization and Conservation Service, which has overall responsibility for the tobacco program, agreed with the factual content of the report but did not comment on the recommendation. (See p. 13.)

Contents

ILLUSTRATIONS

ABBREVIATIONS

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

CHAPTER 1

INTRODUCTION

By letter dated February 9, 1983 (see app. I), 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) no net cost tobacco program. These aspects were (1) whether the program operates at no net cost to the government, (2) whether the assessments required of tobacco owners and producers are sufficient to meet possible losses in stored tobacco purchased through government loans, (3) the extent to which active tobacco farmers have purchased allotments/quotas and whether leasing has diminished, (4) alleged voting irregularities in the 1982 tobacco referendum approving a flue-cured tobacco price-support program, and (5) the actual value of tobacco stored and what percentage is likely to be lost to deterioration over the next 5 years.

PROGRAM DESCRIPTION

Since the 1930's the federal government has operated programs to support and stabilize tobacco prices. The Agricultural Adjustment Act of 1938, as amended (7 U.S.C. §1281 *et seq.*), authorizes USDA to regulate the production of tobacco through acreage allotments (acres planted) and marketing quotas (pounds marketed). The Agricultural Act of 1949, as amended (7 U.S.C. §1421 *et seq.*), authorizes USDA's Commodity Credit Corporation (CCC) to stabilize and support prices through price-support loans to designated producer associations. The associations use the funds from the loans to make cash advances to tobacco producers who are unable to sell their tobacco for at least the price-support rate assigned to the individual grades of tobacco. These cash advances are made in the form of loans to producers. However, the loans--called nonrecourse loans--limit the liability of the producer for repayment of the loan to the value of the loan's collateral, in this case the tobacco under loan. This means that the producer would not be liable for losses which could be incurred by the association in the event that the proceeds from the sale of the tobacco under loan by the association do not recover the full principal and interest costs of the loan. When the tobacco is sold, the proceeds are used by the associations to pay for program costs, including the repayment of loan principal and interest to CCC.

USDA's Agricultural Stabilization and Conservation Service (ASCS), which administers CCC's principal operations (because CCC has no employees of its own), has overall responsibility for regulating the acreage allotment, marketing quota, and price-support programs. The programs are administered locally by ASCS' state, county, and community farmer-elected committees. The tobacco program's administrative expenses are funded through the Department's appropriations and its price-support operations through government borrowings.

Marketing quotas and acreage allotments

The 1938 act specifies that in order for a marketing quota program to be established and regulated by USDA, the program must be approved in a referendum every 3 years by at least two-thirds (or for some tobaccos, at least one-half) of the producers voting. A quota program must be approved by producers before the Corporation will make a price-support loan program available. Once the referendum is approved, all producers are subject to the quota restrictions established by the Secretary of Agriculture and are eligible to receive price-support loans.

For the 1983 crop year,[1] programs were approved for eight kinds of tobacco, including the two primary kinds--flue-cured and burley tobacco--which are the subjects of this report. Marketing quotas for both flue-cured and burley tobacco were approved by over 90 percent of the producers in the last referendums. In addition, flue-cured tobacco producers agreed to an acreage allotment program.

The marketing quota specifies the pounds of tobacco that may be sold from a 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 farmer must have either established a production base traceable to the 1930's when the tobacco program began, subsequently been granted an allotment or quota by ASCS, or purchased an allotment and/or quota from another farm in the same county. An owner of a farm's allotment and/or quota may sell the allotment and/or quota; 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 rent the quota to a producer, giving that producer the right to market tobacco grown on the owner's base farm.

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[1]A crop year is the year in which a crop is normally harvested.

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 is given a pro rata share of the national quota, on the basis of its historical production.

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 a 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. Parity prices were not set for the 1983 crop because price-support levels for that crop were "frozen" at the 1982 level by Public Law 98-59, enacted on July 25, 1983, to help make U.S. tobacco more competitive with tobacco produced in other countries.

USDA does not directly administer the tobacco 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. Since 1938, when the program began, through June 30, 1984, CCC had loaned about $7.6 billion to associations.

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 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" by getting a cash advance from the tobacco association at the price-support rate or wait and hopefully sell the tobacco at a higher price at a later date.

For tobacco put under loan, the associations handle all operations related to making the loan advances to producers and receiving, processing, storing, and eventually selling the tobacco. Over time, the associations market the price-support tobacco under loan on the basis of prices proposed by the associations and approved by CCC. The proceeds from the sales are used to repay the loans from CCC.

No net cost program

For 1981 and prior crop years, the government paid for the program's administrative costs as well as for any principal and interest losses that occurred on the price-support loans. However, the tobacco program was substantially changed when the No Net Cost Tobacco Program Act of 1982 (7 U.S.C. §1445-1, 1445-2) was enacted. This act applies to 1982 and subsequent crop years. The act describes its purpose as implementing Congress' intent that the tobacco price-support and production adjustment programs (acreage allotments and marketing quotas) be carried out at no net cost to the taxpayer, other than the Department's administrative expenses common to the operation of all price-support programs. To accomplish this, producers of marketing quota tobacco are assessed fees to offset anticipated losses on tobacco brought under loan. Losses arise when the sale price of the tobacco is not sufficient to cover expenses. Anticipated losses could include such costs as acquisition, interest, handling, storage, and loss due to deterioration of stored tobacco.

Each producer is required, as a condition of eligibility to receive price supports, to contribute an assessed fee to a fund or account. An account differs from a fund in that an account, such as the one for burley assessments, is established within CCC whereas a fund, such as the one for flue-cured assessments, is established within the individual association. The fund or account is used to ensure that, insofar as practicable, CCC will sustain no net losses from the price-support program. The assessed fee is subject to approval of the Secretary of Agriculture. The Secretary may approve the fee amount only if it is sufficient to reimburse CCC for any losses sustained under its loan agreements with the association.

CCC is to retain gains on the price-support tobacco sold by the associations from 1982 and subsequent crop years. These gains are to be applied against losses on any of the 1982 and subsequent crops, or to reduce outstanding loan balances on any such crop. If the Secretary determines that these gains exceed the amount needed to cover potential CCC losses, they can be refunded to the associations.

The act also made other changes in the tobacco program. It requires allotment/quota owners other than individuals and certain other entities to sell or forfeit their allotments/quotas unless they are significantly involved in the management or use of land for agricultural purposes. These sales or forfeitures must occur no later than December 1, 1984,[2] or December 1 of the year after the farm is acquired, whichever is later. Furthermore, the act authorizes individual owners of the tobacco allotments and/or quotas to sell them to active tobacco producers in the same county or to persons certifying that they will become active tobacco producers in the same county.

OBJECTIVES, SCOPE, AND METHODOLOGY

This report provides information on certain aspects of USDA's flue-cured and burley tobacco programs. In response to the request, our objectives were to determine (1) whether the tobacco program operates at no net cost to the government, (2) whether the assessments required of tobacco owners and producers are sufficient to meet the possible losses in stored tobacco purchased through government loans, (3) the extent to which active tobacco farmers have purchased allotments and/or quotas and whether leasing has diminished, (4) alleged voting irregularities in the 1982 referendum approving a flue-cured tobacco price-support program, and (5) the actual value of tobacco stored and what percentage is likely to be lost to deterioration over the next 5 years.

We made this review in accordance with generally accepted government auditing standards. We did our audit work from April 1983 through August 1983 (and obtained supplementary information through October 1984) primarily at ASCS' headquarters in Washington, D.C., and at its state office in North Carolina. At these places, we interviewed ASCS officials and obtained information on the issues discussed in this report. We obtained and reviewed applicable legislation, implementing regulations, and pertinent USDA policies and procedures. We also obtained allotment/quota sales data from ASCS' Kansas City, Missouri, computer center and leasing data from USDA's Economic Research Service.

We coordinated our work with USDA's Office of Inspector General (OIG) and shared information with that office for its ongoing reviews. We interviewed OIG personnel knowledgeable about the tobacco program and reviewed and commented on OIG's report (No Net Cost Tobacco Program, Computation of Interest on CCC Loans, OIG File No. 3-99-67-At, June 27, 1983) dealing with CCC's method of computing interest on loans made to associations administering the tobacco price-support program. Also, we reviewed OIG's March 23, 1984, report entitled Audit of the No Net Cost Tobacco Program Act of 1982, Audit Report No. 03099-67-At.

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[2]The 1982 act set the date at Dec. 1, 1983. However, the Dairy and Tobacco Adjustment Act of 1983 (Public Law 98-180, Nov. 29, 1983) extended this date to Dec. 1, 1984.

We interviewed officials of one producer association--the Flue-Cured Tobacco Cooperative Stabilization Corporation in North Carolina--to obtain information on matters discussed in this report. We interviewed these officials because 77 percent of the tobacco under loan is flue-cured and is stored by the corporation. We obtained information on the deterioration rate of stored tobacco from corporation officials, several professors with agricultural-related specialties at North Carolina State University, and an official at the North Carolina Department of Agriculture.

We limited our review to flue-cured and burley tobacco because these two types account for over 90 percent of the tobacco production in the United States and Puerto Rico. Through December 31, 1983, portions of the 1975 through 1983 tobacco crops were still under loan. These two types received about 98 percent of the price-support loans made during that period. We concentrated much of our work in North Carolina, the largest tobacco producing state and, according to an ASCS official, the only state whose most recent tobacco referendum was challenged.

Prior GAO reports on the federal tobacco program

We have issued several reports on various aspects of the federal tobacco program. In a January 1982 report,[3] we recommended that CCC bring its interest computation practices for tobacco loans more in line with the method it follows for its Treasury borrowings. We discussed the reasons for the high cost of U.S. tobacco and the need for the Secretary of Agriculture to have more flexibility in setting the price-support levels for the various kinds of tobacco in our April 1982 report.[4] We also reported on CCC's loan repayment practices[5] and on the costs incurred for the 1982 flue-cured and burley crops.[6]

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[3]Collection and Accounting for Accrued Interest on Commodity Credit Corporation Producer Loans, AFMD-82-40, Jan. 11, 1982.

[4]Tobacco Program's Production Rights and Effects on Competition, CED-82-70, Apr. 23, 1982.

[5]Information on Commodity Credit Corporation Loan Repayment Practices, CED-82-106, June 16, 1982.

[6]Cost Information on USDA's Tobacco Program, GAO/RCED-84-33, Dec. 12, 1983.

CHAPTER 2

TAXPAYERS INCUR COSTS IN THE NO NET COST TOBACCO PROGRAM

Although the 1982 act is entitled the No Net Cost Tobacco Program Act of 1982, the program does not operate at no net loss to the taxpayers. As provided in the 1982 act, taxpayers continue to pay for administrative expenses to operate the tobacco program. USDA estimates these expenses, which are common to all price-support programs, to be $41.5 million for fiscal years 1982 through 1984.

Because of CCC's existing loan repayment procedures, taxpayers will also pay for some of the interest costs that CCC incurs in borrowing money from the U.S. Treasury to make tobacco loans. The reason for this is that CCC's procedures for charging interest on its loans to tobacco producer associations differ from the Department of the Treasury's procedures for charging interest on the money CCC borrows to make the loans. We have concluded, however, that the 1982 act does not require CCC to change its procedures for charging interest on its loans to the associations.

The amount of interest costs that taxpayers will incur depends on the amount and value of tobacco placed under loan each year, the length of time the tobacco remains under loan, and the interest rates. For crop year 1982 flue-cured tobacco under loan during the period from July 1982 through June 1984, we estimate that as a result of the difference in interest computation practices, CCC will pay the Treasury $6 million more in interest than it will receive. Also, taxpayers could incur costs if producers vote not to continue a program and if the assessments placed on prior years' crops have not been adequate to cover all losses on those crops.

INTEREST COMPUTATION PRACTICES COSTLY TO TAXPAYERS

The No Net Cost Tobacco Program Act of 1982 describes its purpose as implementing Congress' intent that the tobacco program be carried out at no net cost to the taxpayer. The act requires that a fund or account be established by or for each tobacco association to be used to ensure, insofar as practicable, that CCC will suffer no net losses under its loan agreements with producer associations. The title of the 1982 act, however, is somewhat misleading with regard to its operation. The act does not ensure a no net loss program because it does not require CCC to charge interest on loans to producer associations in an amount sufficient to cover the interest costs it incurs on funds borrowed from the

U.S. Treasury.[1] The act also does not require that fees assessed by the tobacco associations be used to fully reimburse CCC for losses incurred because of CCC's interest computation policy.

The Secretary of Agriculture, who is also CCC's Chairman, has the discretion, as authorized under the Agricultural Act of 1949, as amended (7 U.S.C. §1421 et seq.) and the Commodity Credit Corporation Charter Act (15 U.S.C. §714 et seq.), to adjust CCC interest computation procedures to collect the necessary funds to ensure that the program is carried out at no net loss to the taxpayer. The Charter Act authorizes CCC to support the price of agricultural commodities through loans, purchases, payments, and other operations. The act allows CCC to determine the character of and the necessity for its obligations and expenditures and the manner in which they shall be incurred, allowed, and paid.

In a July 27, 1984, letter to Congressman Thomas E. Petri, we pointed out that the 1982 act does not require CCC to change its procedures for charging interest on tobacco loans. In analyzing the 1982 act and its legislative history, we found an apparent contradiction between the goals of the act, its provisions, and elements of its legislative history. The goal expressed by the Congress in the 1982 act was to achieve a tobacco program that operates at no net cost to the taxpayers. The House and Senate reports, along with numerous statements from the floor debate, echoed the no net cost objective of the 1982 act. However, the statements in the House and Senate debate discussing CCC's procedures which result in interest losses show that the Congress had been advised that CCC's procedures were a continuing source of losses to the tobacco program and that the provisions of the act did not directly address the issue.

We believe that if the Secretary changed the procedures to bring CCC's interest computation provision more in line with the method it follows for its own Treasury borrowings, he would further the basic purpose of the 1982 act and be consistent with sound management principles of cost recovery.

In four prior reports,[2] we discussed CCC interest computation practices. We said that CCC does not compound the interest

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[1]Letter to Congressman Thomas E. Petri, B-213761, July 27, 1984.

[2]Collection and Accounting for Accrued Interest on Commodity Credit Corporation Producer Loans, AFMD-82-40, Jan. 11, 1982; Tobacco Program's Production Rights and Effects on Competition, CED-82-70, Apr. 23, 1982; Information on Commodity Credit Corporation Loan Repayment Practices, CED-82-106, June 16, 1982; and Cost Information on USDA's Tobacco Program, GAO/RCED-84-33, Dec. 12, 1983.

that has accrued on tobacco loans. We pointed out, however, that under Treasury's procedures, CCC is required to pay compound interest on its Treasury borrowings. In our report Collection and Accounting for Accrued Interest on Commodity Credit Corporation Producer Loans (AFMD-82-40, Jan. 11, 1982), we recommended that CCC bring its interest computation practices more in line with the method it follows for its Treasury borrowings; however, the Secretary has not done so.

In a letter dated December 1, 1983, to Senator Thomas F. Eagleton, the Administrator, ASCS (who is also the executive vice president of CCC) provided the agency's position on the interest issue. He said:

> ". . . We do not believe that the no net cost provisions of the 1982 Act require any change in the procedures which are utilized by the Corporation with respect to the charging of and crediting interest under the tobacco price support program. In our view, a substantive change in these procedures would fundamentally alter the structure of the tobacco price support program in a manner which is not contemplated by the provisions of the Act.
>
> "For example, the full recovery of CCC costs for interest would require a 160 percent increase in the assessments which are paid by producers under the provisions of the 1982 Act. The effect of an increase of this magnitude would result in the destruction of the tobacco price support program."

Interest on funds CCC borrows from the Treasury are set at the rate the Treasury charges during the month that the funds are disbursed. The interest is compounded semiannually. On January 1st, the loan principal and interest amounts are rolled over into a composite loan bearing interest at the rate established for the roll-over month. However, at the end of the fiscal year (Sept. 30), CCC totals all interest that has accrued on its note and requests a congressional reimbursement (for net realized losses) to offset the interest expense. After the Congress appropriates the funds, the original principal amount (less any repayment) remains as the outstanding balance due to the Treasury.

CCC charges interest on the outstanding principal amount due; it does not compound accrued interest on any of the tobacco loans it makes. Unless CCC changes its interest procedures to compound interest, program costs will increase because CCC's procedure applies to all tobacco under loan, and similar understated interest costs will occur each year on each kind of tobacco under loan. To illustrate the effects of compounding, we have developed an example using the 1982 flue-cured crop. We estimate that during the first year (July 1982-June 1983) that the 1982 flue-cured tobacco crop was under loan, CCC understated the interest cost due on that crop from the Flue-Cured Tobacco Cooperative Stabilization Corporation's no net cost tobacco fund by about $815,000. Furthermore, because of the effects of compounding, understated interest costs will escalate rapidly. For example, as the following table shows, we estimate that during the first 2 years (July 1982-June 1984) that the 1982 flue-cured tobacco crop is under loan, CCC will collect about $6 million less from the Flue-Cured Tobacco Cooperative Stabilization Corporation's no net cost tobacco fund than it will pay the Treasury for the borrowed funds.

Table 1

Estimate of Cumulative Understated Interest Cost on the 1982 Flue-Cured Crop

Period	Simple interest due at end of period	GAO-computed additional interest due because of compounding	Total[a]
July - Dec. 1982	$18,275,011	$ 0[b]	$18,275,011
Jan. - June 1983	39,918,796	815,615	40,734,411
July - Dec. 1983	63,077,376	2,766,395	65,843,771
Jan. - June 1984	76,743,711	6,049,556	82,793,267

[a]Determined by compounding computed simple interest due on the 1982 flue-cured crop. Calculations of interest due on outstanding principal are not discounted. See appendix II for computation.

[b]Treasury compounds interest on January 1 and July 1 of each year. Because no loans were outstanding for crop year 1982 flue-cured tobacco on July 1, 1982, no compounding was computed at December 30, 1982.

Source: Developed by GAO on the basis of information obtained from USDA.

Additional uncollected interest will accrue as long as any part of the 1982 flue-cured tobacco crop remains under loan. We have not estimated this additional amount because any such estimate would have to be based on assumptions about several hard-to-predict factors, including interest rates and the length of time which the crop would remain under loan. USDA's OIG, however, chose a set of assumptions on which to base an estimate. The OIG assumed that portions of the 1982 flue-cured crop would be under loan for 8-1/2 years and that the interest rate charged would be 10 percent a year for the entire period. In its March 23, 1984, report, the OIG estimated that CCC would lose about $164 million in uncollected interest on the 1982 crop. This figure is not directly comparable to our estimate of $6 million because our estimate is only for understated interest occurring from July 1982 through June 1984.

Different assumptions would yield different estimates of total understated interest costs for the 1982 flue-cured crop. In general, the shorter the time the crop is assumed to remain under loan and the lower the assumed interest rate, the lower the estimate of understated interest costs. For example, ASCS' Tobacco and Peanuts Division assumed that none of the 1982 flue-cured crop would remain under loan beyond 1987 and estimated a total of about $50 million in understated interest costs.

With regard to the ASCS Administrator's statement (see p. 9) that an increase of 160 percent in the assessment for full recovery of interest would "result in the destruction of the tobacco price support program," the Director of ASCS' Tobacco and Peanuts Division said that full recovery of interest would add 5 cents per pound to the assessment if the entire amount were to be collected in 1 year. This figure is derived from ASCS' estimate of total understated interest costs of about $50 million.

Obtaining full recovery of interest costs by the Corporation might be a contributing factor in producers' deciding not to participate in the program. As the Director of ASCS' Tobacco and Peanuts Division stated, the 160-percent increase would amount to 5 cents per pound. Although this increase would be small (about 4 percent) in relation to the cost of producing tobacco (about $1.16 per pound for flue-cured tobacco in 1983, according to USDA's Economic Research Service), we do not know whether the future costs of the program might outweigh its benefits to the producers and thus encourage them not to participate in the program.

The program presently limits the amount of tobacco that can be produced and marketed and, in 1983, guaranteed flue-cured tobacco producers an average loan rate of $1.70 per pound. (Producers not putting their flue-cured tobacco under loan received a market price of about $1.80 per pound in 1983.) The program also allows individual owners of allotments to sell, rent, or lease them to tobacco growers. The average rental value of quotas/allotments in 1983 was 44 cents a pound.[3] If this program was discontinued as a result of producers' voting not to participate any longer, they would be free to produce as much tobacco as

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[3]Estimate by USDA's Economic Research Service. We reported (CED-82-70, Apr. 23, 1982) that in 1981 about 83 percent of the owners in the flue-cured tobacco regions and about 53 percent in the burley areas leased or rented their quotas. Many owners were receiving from 25 cents to 90 cents per pound at that time.

they wanted, but they would not have any price guarantees, nor would they have allotments/quotas to sell, rent, or lease.

We asked ASCS to clarify its position on the impact of charging interest for the tobacco program. ASCS supplied us with a September 13, 1984, memorandum from the Director, Tobacco and Peanuts Division, which stated the effect of increased assessments for the charging of interest would contribute to the elimination of all the positive benefits of the price-support program and could cause grower disapproval of marketing quotas in future referendums. Because any estimates of total costs of the program are based on assumptions about highly uncertain variables, any predictions one might make about the assessment level needed for full-cost recovery and whether it would cause producers to choose not to participate are conjectural. Furthermore, as stated above, the program is of considerable benefit to allotment and quota holders because of the rental fees they are able to charge growers. In the absence of a tobacco program, they would not have any allotments or quotas for which to charge fees.

PRODUCER REJECTION OF PROGRAM COULD INCREASE PROGRAM COST

For a marketing quota and acreage allotment program to be in effect on any kind of tobacco, the program must be approved in a referendum by at least two-thirds (or for some tobaccos, at least one-half) of the producers voting. If a program is approved, producers pay into an account or fund an assessment on each pound of tobacco marketed to cover anticipated losses on crops placed under loan. However, according to the Deputy Director, Tobacco and Peanuts Division, if the producers do not approve continuation of the program, taxpayers would pay losses on any tobacco brought under loan in prior crop years unless producers vote in a subsequent referendum to reinstate the program. He further said that in such a case, assessments would be made to cover any actual or projected losses from previous crops as well as projected losses from the current crop.

In a referendum conducted from February 27 through March 1, 1984, cigar-binder tobacco producers disapproved national marketing quotas. As a result, the program for cigar-binder tobacco was terminated, and producer contributions to the no net cost tobacco account will not be collected, unless producers vote to reinstate the program in a subsequent referendum. As of December 31, 1983, 1.1 million pounds of crop year 1982 and 1983 cigar-binder tobacco was under loan, with principal and interest outstanding totaling $2.1 million. Because a program is no longer in effect, any losses on this tobacco, to the extent not offset by previously collected assessments, would be paid by the taxpayer.

Should flue-cured and burley producers also decide against approving a program, whether in response to an increased assessment or for some other reason, future assessments could not be placed upon them, and taxpayers would be liable for any losses that occur on flue-cured and burley tobacco under loan. These losses could be extensive because of the large amount of flue-cured and burley tobacco under loan. The principal and simple interest due on crop year 1982 and 1983 flue-cured and burley tobacco totaled about $1.5 billion on December 31, 1983.

CONCLUSIONS

The government continues to incur expenses in administering the tobacco program. Some of the expenses are common to all price-support programs and, under the No Net Cost Tobacco Program Act of 1982, are to be paid by the taxpayer. However, other expenses are incurred because of understated interest costs on tobacco loans that are not required to be recovered by the act. For the 1982 flue-cured tobacco crop alone, understated interest costs from July 1982 through June 1984 totaled over $6 million. Because of CCC interest computation practices, understated interest costs on the 1982 and subsequent year tobacco crops placed under government loan will increase.

Under its current practices, CCC is collecting substantially less interest on loans made to tobacco associations than it pays the Treasury to borrow funds. Although the 1982 act does not require these costs to be recovered, the Secretary has the discretionary authority to adjust CCC's procedures for charging interest on loans to tobacco producer associations to ensure that the tobacco program operates at no net loss to the taxpayer. In addition, should producers not approve a program, taxpayers would assume the costs associated with disposing of the tobacco under government loan, to the extent the costs are not covered by previously collected assessments.

RECOMMENDATION TO THE CONGRESS

Because the Department and CCC have not acted on our prior recommendation to bring CCC's interest computation provision more in line with the method it follows for its Treasury borrowings, we recommend that, if the Congress wants to ensure that no costs to the taxpayer will result from CCC's interest computation practices for the tobacco program, the No Net Cost Tobacco Program Act of 1982 be amended to require that the amount of payments on principal and interest that the tobacco producer associations pay CCC on tobacco price-support loans must equal the amount of payments on principal and interest that CCC pays the Treasury for borrowed funds.

AGENCY COMMENTS

In commenting on a draft of this report, the Acting Administrator, ASCS, stated that he reviewed the draft and concurred in the report's factual content. However, he said that ASCS had no comment to make on the report's recommendation. (See app. III.)

CHAPTER 3

ADEQUACY OF PRODUCER ASSESSMENTS FOR 1982 AND SUBSEQUENT YEARS' FLUE-CURED AND BURLEY TOBACCO CROPS

To implement the No Net Cost Tobacco Program Act of 1982 and ensure against government losses, the tobacco associations assess tobacco producers an annual fee, approved by the Secretary of Agriculture, on each pound of tobacco marketed (including the tobacco consigned to a producer association) to cover anticipated losses on those crops placed under government loan. The anticipated losses could include costs for expenses such as interest, handling, storage, and loss due to deterioration of stored tobacco.

The producer assessment is deducted from the proceeds at the time the tobacco is marketed. Producer assessments in future years can be increased if earlier years' assessments are inadequate to cover costs. Because the no net cost program was new when producer assessments were first established, there was little experience on which to predict the adequacy of the initial assessments. The inability to predict precise assessments was discussed in a July 27, 1983, report from the Director of ASCS' Tobacco and Peanuts Division to the CCC Board of Directors. The ASCS report estimated that the assessments on the 1982 flue-cured and burley tobacco crops would be inadequate to cover anticipated losses on these crops.

For 1982, the flue-cured assessment was 3 cents per pound, and the burley assessment was 1 cent per pound. These assessments, which were based on, among other things, the expected volume of tobacco coming under loan and the anticipated carrying and interest costs, generated $29.5 million and $7.5 million for the flue-cured and burley programs, respectively, to be used to cover anticipated losses on the crops. According to the ASCS report, the assessments that USDA approved were inadequate to ensure a no net cost tobacco program for the 1982 crop year, and an additional $60.5 million for the flue-cured crop and $112.5 million for the burley crop would be needed to recover program costs. (As discussed on p. 16, the estimated shortfall on the burley crop was later eliminated.)

According to the report, a record volume of 1982 tobacco came under loan which was partly due to economic recession here and overseas, tax increases on cigarettes, and price increases. This caused tobacco manufacturing companies to reduce purchases because consumers bought less cigarettes. The report stated that the larger than expected loan volumes would result in larger projected losses than had been earlier indicated for the 1982 crop. ASCS planned to collect the shortages through increased assessments on the 1983 and 1984 crops.

FLUE-CURED ASSESSMENTS

Before the 1982 flue-cured marketing season opened, the Flue-Cured Tobacco Cooperative Stabilization Corporation projected potential losses of $30 million on that portion of the crop placed under government loan. In making its projection, the corporation assumed that (1) 100 million pounds of flue-cured tobacco would be placed under government loan, (2) the sales price of tobacco would inflate by 6 percent a year, (3) interest on funds borrowed to purchase and process the 1982 crop would be 12 percent, and (4) 20 percent of the tobacco taken under government loan would be sold to commercial companies each subsequent year. On the basis of its projection, the corporation proposed, and the Secretary approved, an assessment of 3 cents per pound on the estimated 1-billion-pound 1982 crop. The assessment generated $29.5 million to cover anticipated losses.

The Flue-Cured Tobacco Cooperative Stabilization Corporation took under loan about 259 million pounds of the 994-million-pound 1982 flue-cured crop, thereby exceeding its estimate by about 160 million pounds. According to ASCS, tobacco producers will be required to contribute an additional $60.5 million to ensure against possible government losses. ASCS data show that to collect this amount, 4 cents of the 7-cent-per-pound assessment on the 1983 crop and 2 cents of the 7-cent-per-pound assessment on the 1984 crop are intended to be used to cover potential losses on the 1982 crop.

However, other factors may adversely affect these assessments. For example, the Flue-Cured Tobacco Cooperative Stabilization Corporation's projected 6-percent annual inflation rate in tobacco prices could be affected by 1983 legislation (Public Laws 98-59, July 25, 1983, and 98-180, Nov. 29, 1983) which froze price-support levels for the 1983-84 flue-cured crops at the 1982 level. In the past, the corporation has increased the sales prices of loan stock tobacco monthly to recover carrying and interest costs that accrue on the loans. While making the 1983-84 crops more marketable, the price-support freeze on those crops could make it difficult to increase 1982 crop sales prices to recover costs and, at the same time, to maintain its marketability. Corporation officials predict that prices for the 1982 crop will not increase as originally projected.

Flue-Cured Tobacco Cooperative Stabilization Corporation officials recognize that the 1982 assessment was not sufficient and told us that predicting what will happen with tobacco sales is difficult. They also told us that the accuracy of the assessment for the 1982 crop is not important because the tobacco program is required by law to operate at no net cost to the government. Thus, adjustments in future producer assessment rates will have to be made.

BURLEY ASSESSMENTS

Producer assessments on the 1982 burley crop illustrate the difficulty in projecting potential losses on tobacco taken under government loan. Although only 770,000 pounds of burley tobacco was placed under government loan in crop year 1981, over 269 million pounds came under government loan in 1982, when burley production totaled 777 million pounds.

On the basis of burley tobacco sales in prior years, ASCS initially collected $7.5 million to cover potential losses on the 1982 crop. This amount was collected by assessing burley producers 1 cent for each pound of tobacco marketed. After the 1982 crop was marketed, the Director, Tobacco and Peanuts Division, ASCS, estimated that because of the large amounts of tobacco which came under loan, burley producers would have to be assessed an additional $112.5 million to ensure against potential government losses. However, this initial loss estimate was eliminated as a result of increased purchases of 1982 crop year tobacco which was under loan. Tobacco purchasers anticipated that the drought-ridden 1983 burley crop would be of poor quality, and they purchased 116 million pounds of crop year 1982 burley tobacco during August and September 1983. According to the Department, as a result of these purchases, the 1982 assessment should be adequate to cover program costs on the remaining 1982 burley crop under loan.

CONCLUSIONS

It will be several years until USDA can determine the exact amount of producer assessments that will be needed to ensure that the 1982 flue-cured tobacco crop that came under government loan will be disposed of at no net loss to the government. However, information compiled by ASCS indicates that producer assessments collected when the 1982 flue-cured crop was marketed are substantially less than anticipated to ensure against potential government losses. While the additional amounts needed are to be collected in future years, this will result in producer assessments being higher than otherwise for those years.

As discussed in chapter 2, a variance exists between the procedures the Treasury Department uses in charging interest on loans to CCC and the procedures CCC uses in charging interest on loans to tobacco producer associations. This variance between CCC and Treasury procedures creates a significant difference between the amount of interest CCC records and collects from tobacco producer associations and the corresponding interest which CCC pays the Treasury for borrowed funds. The result is a net loss to CCC. To ensure a no net loss program, full interest costs should be collected. To cover these costs, future producer assessment fees on both flue-cured and burley tobacco would have to be increased.

CHAPTER 4

LEASING AND SALES OF TOBACCO ALLOTMENTS AND QUOTAS

The 1982 act amended the provisions of the 1938 act for leasing tobacco allotments and/or quotas and, for the first time, provides for the voluntary sales[1] of flue-cured allotments and quotas and, in some cases, mandatory sales[2] of flue-cured and burley allotments and/or quotas. Leasing of flue-cured and burley quotas decreased in crop year 1983 from the amounts leased in crop year 1982. The amount of the crop year 1983 flue-cured tobacco quota that was leased decreased by about 29 percent, or about 136 million pounds, from the 465 million pounds leased in crop year 1982; and the amount of burley tobacco that was leased decreased by about 11 percent, or about 20 million pounds, from the 185 million pounds that was leased in crop year 1982.

USDA rules which provide for flue-cured tobacco allotment and quota owners to voluntarily sell their allotments and quotas were published as an interim rule on December 17, 1982, and adopted as a final rule on September 8, 1983. USDA's rules for mandatory sales of flue-cured and burley tobacco allotments and/or quotas were also finalized on September 8, 1983. As of May 24, 1984, quotas covering about 17.4 million pounds of flue-cured tobacco, representing less than 2 percent of the 1983 quota, and quotas for about 43,000 pounds of burley tobacco, representing less than 1 percent of the 1983 quota, had been sold.

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[1]Voluntary sales allow allotment and quota owners to sell their allotments and quotas.

[2]The mandatory sales provision of the act for flue-cured tobacco requires any person (including, but not limited to, any governmental entity, public utility, educational institution, or religious institution, but not including any individual, partnership, family farm corporation, trust, estate or similar fiduciary account with respect to which the beneficial interest is in one or more individuals, or any educational institution that uses a flue-cured acreage allotment or quota for instructional or demonstration purposes) which on or after July 20, 1982, owns a farm with an established acreage allotment or marketing quota and who is not significantly involved in the management or use of land for agricultural purposes to sell or forfeit their allotments and/or quotas. The act, as amended, further requires that burley quota owners (including, but not limited to, any governmental entity, public utility, educational institution, or religious institution; but not including any individual) shall sell their quotas if they do not use the land on the farm for agricultural purposes or do not use the farm's burley marketing quota for educational, instructional, or demonstration purposes.

LEASING OF TOBACCO ALLOTMENTS/QUOTAS

Significant numbers of flue-cured and burley tobacco allotment and/or quota owners rent or lease their allotments and/or quotas. In a rental situation, the producer grows the tobacco on the owner's farm whereas in a leasing situation (which is the subject of this chapter), the tobacco is grown on another farm in the same county. ASCS maintains and reports statistical information on tobacco leasing activity; however, it does not record and report the number of rentals.

In our April 23, 1982, report Tobacco Program's Production Rights and Effects on Competition (CED-82-70), we reported that in 1981 about 57 percent of the owners in the flue-cured tobacco regions and about 27 percent in the burley areas leased their quotas. We found that only 12 percent of the flue-cured owners grew their quotas compared with 40 percent of the burley owners. About 26 percent of both types of owner rented their tobacco quotas. The remaining 5 percent either allowed a relative to grow and market the quota or allowed the quota to go unused.

We reviewed agency records on burley and flue-cured tobacco-leasing activity for crop years 1980-83. The information disclosed that since the 1982 act was passed, leasing of burley and flue-cured tobacco quotas had decreased rather substantially as shown in the following tables. For example, quotas covering about 329 million pounds of flue-cured tobacco were leased and transferred to other farms for crop year 1983. This is about 136 million pounds less (a reduction of 29 percent) than the amount leased for crop year 1982.

Table 2

Flue-Cured Tobacco Leasing Activity, Crop Years 1980-83

Crop year	Approximate total quota	Approximate quota leased
	--------(million pounds)--------	
1980	1,187	500
1981	1,111	476
1982	977	465
1983	887	329

Source: Economic Research Service, USDA.

Table 3

Burley Tobacco Leasing Activity, Crop Years 1980-83

Crop year	Approximate total quota	Approximate quota leased
	--------(million pounds)--------	
1980	769	140
1981	842	186
1982	778	185
1983	641	165

Source: Economic Research Service, USDA.

Also, the number of farms leasing out their flue-cured tobacco quotas decreased in 1983 for the first time in 4 years. Of a total of about 191,000 farms, 109,807 leased out their 1983 quotas compared with 130,127 in 1982. ASCS county executive directors told us that the reasons for this leasing decrease for 1983 included a reduction in the quota, permanent sales of flue-cured tobacco allotments/quotas, and increased use of cash rent arrangements.

SALES OF FLUE-CURED AND BURLEY ALLOTMENTS AND/OR QUOTAS

Before the 1982 act, a flue-cured tobacco allotment and quota could not be sold without also selling farmland. The 1982 act amended the 1938 act and revised this procedure to allow flue-cured allotment and quota owners to voluntarily sell their allotments and quotas. In some cases, the 1982 act mandates the sale of flue-cured and burley tobacco allotments and/or quotas.

The 1938 act, as amended, requires that, except for individuals and certain other entities,[3] flue-cured tobacco allotment and/or quota owners (including, but not limited to, governmental entities, public utilities, educational institutions, and religious institutions) shall sell their allotments and/or quotas unless they are significantly involved in the management or use of land for agricultural purposes. The act, as amended, further

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[3]Namely, any partnership; family farm corporation; trust, estate, or similar fiduciary account with respect to which the beneficial interest is in one or more individuals; or educational institution that uses a flue-cured acreage allotment or quota for instructional or demonstration purposes.

requires that burley quota owners (including, but not limited to, any governmental entity, public utility, educational institution, or religious institution; but not including any individual) shall sell their quotas if they do not use the land on the farm for agricultural purposes or do not use the farm's burley marketing quota for educational, instructional, or demonstration purposes.

USDA's rules for mandatory sales of flue-cured and burley tobacco allotments and/or quotas were proposed on December 17, 1982, and April 22, 1983, respectively, and finalized on September 8, 1983. Under the 1938 act, as amended by the Dairy and Tobacco Adjustment Act of 1983, such sales must occur no later than December 1, 1984, or December 1 of the year after the year the farm is acquired, whichever is later.

The 1982 act also authorizes owners of flue-cured tobacco allotments and quotas to voluntarily sell all or any part of their allotments and quotas to active tobacco producers or persons certifying that they will become active tobacco producers, in the same county. USDA's September 8, 1983, rule provided that allotment and quota purchases must be assigned to a specific farm and cannot be resold for at least 5 years except to prevent forfeiture.

ASCS data show that as of May 24, 1984, owners of flue-cured tobacco quotas had sold quotas totaling 17,421,943 pounds. This amounts to less than 2 percent of the 1983 national flue-cured marketing quota. Furthermore, burley quota owners sold 43,022 pounds of quota, which amounted to less than 1 percent of the 1983 national burley marketing quota.

CHAPTER 5

RESULTS OF THE LATEST FLUE-CURED

TOBACCO REFERENDUM

Since 1933, USDA has administered programs to stabilize tobacco production and ensure fair prices to producers. Government-imposed price-support programs are available for all types of tobacco, provided they are approved by eligible producers in a referendum. Referendums are held to determine if producers of each kind of tobacco want a marketing quota and price-support program to be in effect for a 3-year period. The referendum must be approved by at least two-thirds (or for some tobaccos, at least one-half) of the producers voting before government price-support programs can be instituted.

The most recent referendum for flue-cured tobacco was held on December 16, 1982. Of the 112,314 tobacco producers voting, about 93.7 percent voted in favor of marketing quotas and price support. Therefore, national quotas were approved for marketing years 1983-84, 1984-85, and 1985-86. The approval rate was down somewhat from the 97.7-percent approval rate in the December 1979 referendum and the 98.5-percent approval rates in the 1973 and 1976 referendums. Although the 1982 referendum was easily approved, the North Carolina State ASCS Committee received complaints that ineligible voters in five counties contributed to the large margin.

ALLEGED VOTING IRREGULARITIES

Voting irregularities were alleged by individuals in 5 of North Carolina's 69 flue-cured tobacco growing counties--Franklin, Harnett, Nash, Randolph, and Wilson. In the five counties, the approval rate on the December 1982 referendum was 93.2 percent. After receiving complaints that ineligible persons voted, the state ASCS committee asked the five county ASCS committees to verify the eligibility of voters in these counties. According to the state ASCS committee, the county committees reported that 3,117, or about 36 percent, of the 8,627 persons voting appeared to have been ineligible. The percentages of apparently ineligible voters were 39 percent in Franklin County; 24 percent in Harnett County; 45 percent in Nash County; 1 percent in Randolph County; and 49 percent in Wilson County. In a January 14, 1983, letter to the Director of ASCS' Tobacco and Peanuts Division, the North Carolina State ASCS Executive Director said that these figures could possibly be excessive because the county committees had not thoroughly investigated each voter's eligibility because it would have required a tremendous amount of time and expense.

The state ASCS committee concluded, however, that if all the apparently ineligible votes were subtracted from the "yes" vote in these counties, the referendum's outcome would not have changed. That is, if the 3,117 apparently ineligible votes were subtracted from the 8,039 "yes" votes in the five counties, the percentage of votes favoring market quotas would have decreased to 89.3 percent from the five counties' original 93.2 percent. The state ASCS committee concluded that the irregularities alleged in the five counties were insufficient to warrant any further investigations.

CHAPTER 6

VALUE OF TOBACCO UNDER LOAN

AND EXTENT OF ITS DETERIORATION

USDA records show that as of December 31, 1983, about 734 million pounds of flue-cured tobacco valued[1] at about $1.65 billion and about 189.5 million pounds of burley tobacco valued at about $543.5 million were under loan to CCC and stored in either government warehouses or commercial warehouses under contract to grower associations. We were unable to determine any specific rate of deterioration for stored tobacco. However, according to tobacco specialists, the quality of stored tobacco generally improves for the first 2 or 3 years, after which the quality slowly declines.

VALUE OF STORED TOBACCO UNDER GOVERNMENT LOAN

The following table shows, by crop year and in total, the flue-cured and burley tobacco inventory as of December 31, 1983, and its estimated value.

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[1]Value is defined as the total principal and simple interest due as calculated by CCC. The amount would be higher if CCC compounded the interest due on loans. Market value is determined by selling price; consequently, value as shown here is not necessarily the market value of the tobacco under loan.

Table 4

Value of Flue-Cured and Burley Tobacco Under Government Loan

Crop year	Flue-cured tobacco: Number of pounds	Flue-cured tobacco: Value	Burley tobacco: Number of pounds	Burley tobacco: Value
1975	23,701,000	$ 49,420,000	-	-
1976	29,299,000	44,941,000	-	-
1977	111,611,000	202,651,000	-	-
1978	16,080,000	24,915,000	-	-
1979	18,080,000	34,436,000	-	-
1980	57,760,000	129,200,000	-	-
1981	83,376,000	217,388,000	461,000	$ 1,344,000
1982	226,795,000	573,893,000	175,019,000	492,393,000
1983	167,293,000	373,731,000	13,999,000	49,779,000
Total	733,995,000	$1,650,575,000	189,479,000	$543,516,000

Source: ASCS.

DETERIORATION RATES FOR STORED TOBACCO

Because the tobacco taken under loan by producer associations may be stored for several years before being sold, the rate at which tobacco deteriorates is an important factor in determining its marketability. Professors at North Carolina State University, the Tobacco Affairs Chief for the North Carolina Department of Agriculture, Flue-Cured Tobacco Cooperative Stabilization Corporation officials, and ASCS officials told us that the specific rate of deterioration for stored tobacco cannot be determined; consequently, how much stored tobacco will be lost to deterioration is unknown. However, the consensus of those we interviewed was that properly stored tobacco is usable for many years and that the quality generally improves for the first 2 or 3 years, after which the quality slowly declines.

United States Senate

COMMITTEE ON APPROPRIATIONS
WASHINGTON, D.C. 20510

February 9, 1983

Honorable Charles Bowsher
Comptroller General of the United States
General Accounting Office
Washington, D. C. 20548

Dear Mr. Bowsher:

Last year you reported to us on a request made to evaluate portions of the tobacco price support program. In that report, "Tobacco Program's Production Rights and Effects on Competition," CED-82-70, serious problems became evident, and Congress responded by passage of the "No Net Cost" tobacco legislation. A marketing year has passed since enactment of these provisions, and we would appreciate an additional review of particular issues surrounding this new legislation.

-- We would like you to review the No Net Cost program, and determine whether or not it is indeed no net cost.

-- We would like to determine if, under the allotment sale provisions of the legislation, more active tobacco farmers have purchased allotments, and if fewer are leasing allotments.

-- Recently, the national tobacco program referendum was held. From news reports, there appeared to be considerable discrepancies in the manner in which the referendum was held, and the number of voters participating. We would be interested in a review of the participation of individuals not specifically engaged in the production of tobacco in the referendum.

-- We would be interested in determining whether the assessment required of farmers on quota poundage marketed is sufficient to meet the possible costs of large losses in stored tobacco due to warehouse deterioration.

-- We would like to know the actual value of tobacco stored in government tobacco warehouses, and what percentage is likely to be lost to deterioration over the next five years, and its value.

Hon. Charles Bowsher, p. 2
February 9, 1983

Our staff members will be happy to meet with your staff on this matter, and we will look forward to working with you.

With kind regards.

Sincerely,

Tom Eagleton

Thomas F. Eagleton
Ranking Minority Member
Subcommittee on Agriculture, Rural Development, and Related Agencies

Mark O. Hatfield
Chairman

Semiannual Compounding of Simple Interest Due on the 1982 Flue-Cured Crop

(1) Interest period	(2) Interest computation date	(3) Simple interest due at end of period	(4) GAO-computed additional interest due at end of period because of compounding	(5) Cumulative additional interest due because of compounding	(6) Total interest due at end of period[a]
July-Dec. 1982	Dec. 1982	$18,275,011	$ 0[b]	$ 0	$18,275,011
Jan.-June 1983	June 1983	39,918,796	815,615[c]	815,615	40,734,411
July-Dec. 1983	Dec. 1983	63,077,376	1,950,780[c]	2,766,395	65,843,771
Jan.-June 1984	June 1984	76,743,711	3,283,161[c]	6,049,556	82,793,267

[a](3) + (5)

[b]Treasury compounds interest on January 1 and July 1 of each year. Because no loans were outstanding for crop year 1982 flue-cured tobacco on July 1, 1982, no compounding was computed at December 30, 1982.

[c]Formula for compounding is amount of interest due at the beginning of the period (A) times the prevailing interest rate (R) divided by the number of days in a year (X) times the number of days in the semiannual period (Y) equals the additional interest due because of semiannual compounding (I), or $A(R/X)Y = I$. Thus:

$$\$18,275,011 \times (.09/365) \times 181 = \$815,615$$

$$\$40,734,411 \times (.095/365) \times 184 = \$1,950,780$$

$$\$65,843,771 \times (.10/365) \times 182 = \$3,283,161$$

Source: Developed by GAO on the basis of information obtained from USDA.

United States Department of Agriculture

Agricultural Stabilization and Conservation Service

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

SUBJECT: GAO Draft Report RCED-84-45 Dated September 27, 1984, Entitled "Department of Agriculture and Producer Costs to Operate the Tobacco Program"

TO: J. Dexter Peach, Director, Resources, Community, and Economic Development Division
U.S. General Accounting Office

On October 11, 1984, we met with GAO staff to discuss your draft report entitled "Department of Agriculture and Producer Costs to Operate the Tobacco Program." During that meeting we provided information which updates the report. We have thoroughly reviewed the draft and concur in the facts presented. We have no comments to make on the report's recommendation at this time.

Enclosed are two copies of the draft report with penciled comments, one with comments by OBPA, and the other with comments by ASCS.

C. Hoke Leggett

Administrator

Enclosure

GAO note: Enclosures are not reproduced in this report.

ASCS

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