Budget Cut Fever Wounds Tobacco

by Robert Hodierne

WASHINGTON – Rep. Charles Rose (D-N.C.) has uttered the unutterable. The Chairman of the House Tobacco and Peanuts Subcommittee, a man with 14,000 tobacco farmers in his district, has suggested raising the federal cigarette tax. This heretical deviation from established tobacco-country dogma indicates just how threatened supporters of tobacco farmers feel in Washington these days. After all, the federal cigarette tax, set at eight cents-a-pack in 1951, has not been altered in 30 years. Despite almost annual attempts to increase it, congressmen from the Carolinas, Virginia, and Kentucky have always treated such proposals as direct threats to family farms and the American way of life.

Rose is willing to talk now about a cigarette tax hike because he sees it as a possible way to underwrite the growing losses the tobacco program is suffering. Paid for by taxes at a time when a budget cutting revolution is sweeping through Washington, these losses make the program especially vulnerable to political and fiscal attacks.

The debates over the program have shifted from a health orientation to the bottom line of costs to the taxpayer. On March 12 of this year, David Stockman, director of the Office of Management and Budget and leading architect of the Reagan administration cuts, told the Senate Budget Committee how he viewed the tobacco price support program: "...mostly it is a positive cost to the government, and I think it is too costly and we ought to find some way to do something about it."

On May 12, an unlikely ally for Stockman emerged, Sen. Howard Metzenbaum (D-Oh.). On the Senate floor, he proposed an amendment to the budget resolution that would have deleted $79 million to be used by the Commodity Credit Corporation for tobacco loans. The Senate defeated the amendment by a 56-42 vote. Not since the late 1930s has the program been so threatened – either in Congress or within the federal administration.

When defending the price support program, tobacco backers always point out that it doesn't cost much. Literature distributed by grower and industry groups as well as their supporters in Congress put the cost of the program since its start in 1933 at $57 million in losses to the government. But the $57 million figure seriously understates the cost of the program, a fact that has not escaped the eyes of the Reagan budget team. In the first wave of cuts under the new administration, the tobacco program has already been wounded twice.

In past years, the federal government has paid for the grading of tobacco, an essential step in the leaf marketing system. Tobacco support levels are set for each grade of the leaf, and there are over 130 different grades. To insure that the system works without fraud, government employees place the tobacco into a particular grade. The services of these federal graders cost taxpayers $6.5 million in 1980, and the Stockman team decided that item could go. This season, federal graders will still be at the warehouses, but tobacco farmers will have to pay for that service, not the nation's taxpayers.

A more complicated budget-saving step taken by the administration involves loans from the Commodity Credit Corporation (CCC) (in conjunction with the USDA tobacco program) to farm co-ops (including tobacco co-ops). In the past, the CCC set the interest rate once a year for the loans to the tobacco co-ops at a rate which was often well below market levels in the course of the next 12 months. This resulted in the federal government sometimes loaning money to farm cooperatives at interest rates lower than those at which it was borrowing. For the 1980 crop, for instance, the tobacco co-ops borrowed money from the CCC at 11.5 percent, but during the year the U.S. Treasury borrowed the money it loaned to the co-ops at interest rates as high as 15.1 percent. This interest rate differential was functioning in effect as a subsidy to the tobacco program.

In 1980, this subsidy cost taxpayers about $6 to $8 million, according to the USDA. The Reagan administration has altered this system so that the rate for the CCC loans to the tobacco co-ops is adjusted to the prevailing market rate twice a year. In 1981, taxpayers will not underwrite this subsidy; the tobacco co-ops will absorb the extra interest costs.

The two Reagan administration money-saving actions – eliminating the federally funded grading

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service and changing the interest-setting system on CCC loans to co-ops – would have saved the taxpayers about $13 million under 1980 conditions, a small amount when considering the size of the federal budget. But there is a much larger cost to the taxpayer for the tobacco program, one that is rarely mentioned and even less frequently understood: the interest on loans that tobacco cooperatives have failed – and will fail – to repay. No one at the USDA or at CCC has computed the total. But Lester LeCompte, CCC controller, estimates that the total cost of the interest subsidy plus the interest that has not been repaid at all comes to well over $500 million since the program began.

The largest of the co-ops, the Raleigh-based Flue-Cured Tobacco Cooperative Stabilization Corporation, has failed to repay $127 million in interest since 1946, according to its general manager Fred Bond. (Bond is quick to note that it *has* repaid $171 million in interest.) But there are signs that the 13 tobacco co-ops may not be able to repay larger amounts in the future. The co-ops purchase tobacco which does not bring a market price at least one cent above the federal price support level for that grade. In the past seven years, inventories of leaf purchased by the co-ops have increased dramatically, especially in the lower grades. Imported tobacco at comparable grades sells at about half the American support price level and has hence become a more attractive buy than American low-grade leaf. The current inventory in all tobacco co-ops stands at about 592 million pounds, worth $835 million, which is up from $652 million just four years ago but down from the 1979 peak of $903 million. The 1974 crop is the last one which has been completely sold from inventory. Receipts from those sales were enough to pay off the principal owed CCC but fell $7 million short on interest owed, according to USDA figures. Bond puts that interest shortage at $5.9 million and estimates that the 1975 crop will fail to repay about $9 million in interest.

As long as the cheap imported tobacco is available and cigarette makers keep buying it instead of domestic leaf, USDA economists worry that there will be increasing difficulty in moving tobacco out of the co-ops' inventory. The longer it sits there, the higher the interest bills and the higher the costs of the tobacco program. If cost analysis is to be the most important criterion of the Reagan administration for continuing a federal program, the recent Senate vote on the CCC loans might signal even closer calls for the program's repeal.

Discussions continue among tobacco groups, policymakers, and others concerning the possibility of limiting imports of foreign tobacco. But solving the inventory problem of the co-ops via this route appears unlikely. For example, the manufacturers are staying away from the issue and do not plan to take part in the International Trade Commission hearings on tobacco imports this summer. "It's a grower's issue," says William Toohey, Jr., spokesman for the major tobacco manufacturing lobby, The Tobacco Institute. Such a stance has widened the growing schism between those who grow tobacco and those who roll it into cigarettes.

But meanwhile, the pace of Washington budget cutters does not allow for tobacco interests to work out their own problems. Tobacco congressmen are working overtime to insure the tobacco program's survival, even if it means considering an increase in the cigarette tax.

"I think we can keep the program," Rose says of the price support program. "The question is, how do we pay for it?...If we get caught in the squeeze of all budgets we might have to find another way to finance it."□

Buyers bidding on leaf which has already been graded.
Photo courtesy of N.C. State University