False Friends

The U.S. Cigarette Companies' Betrayal of American Tobacco Farmers

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To request additional copies of the report, contact the Campaign for Tobacco-Free Kids at 202-296-5469 or growers@tobaccofreekids.org. The report and its Executive Summary also can be downloaded from the Campaign's website, www.tobaccofreekids.org.

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Eric N. Lindblom

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The U.S. Cigarette Companies' Betrayal of American Tobacco Growers
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Executive Summary

Tobacco farming has played an important role in this nation's history, dating back more than 200 years. Today tobacco growers face an uncertain future after years of declining tobacco leaf purchases and declining profitability—trends that have already led to a dramatic decrease in the number of small, family-owned tobacco farms.

The purpose of this report is to analyze these trends and the actions that have led to the current state of affairs. There are four central conclusions:

1. The American tobacco grower is facing increasingly hard times. In the 1950s there were more than 500,000 small family tobacco farms. Today there are fewer than 85,000, with a drop of more than 100,000 just since 1980. Purchases of U.S.-grown tobacco leaf are down, farming costs are up, prices are not keeping up with inflation, and grower profits have shrunk steadily.
2. The reduced purchases of U.S.-grown tobacco leaf have little to do with the gradual smoking declines in the United States. Instead, they are tied almost entirely to the decisions of the U.S. cigarette companies to manufacture more of their products overseas and to use more foreign-grown tobacco in the cigarettes that they make both here and abroad. Since 1980, the U.S. share of worldwide tobacco exports has been cut almost in half. Although American manufacturers are now selling more cigarettes than ever before, from 1997 to 1999 the U.S. cigarette companies reduced their purchases of American tobacco leaf for domestic cigarette manufacturing by roughly 35 percent.
3. While the interests of the American tobacco farmer and the American tobacco manufacturer were once the same, this is no longer true. The U.S. cigarette companies have chosen to maximize their profits by relying on less-expensive foreign labor and cheap foreign-grown tobacco while sacrificing the economic well-being of the American tobacco farmer.
4. If current trends continue, the worldwide sales and profits of the major American tobacco manufacturers will grow steadily, and family-owned tobacco farms in the United States will continue to disappear. Those that remain will face a difficult and uncertain future. Accordingly, U.S. tobacco growers have begun to explore new options and strategies and create new alliances with the public health community.

The U.S. Cigarette Companies' Move Overseas

In recent years, the major U.S. cigarette companies have dramatically increased their overall sales, revenues, and profits by expanding foreign markets for their cigarettes. But the good times for the manufacturers have not translated into good times for America's farmers. This increased global demand for "American-blend" cigarettes could have significantly increased the overall demand for U.S. tobacco leaf and American-made cigarettes. Instead, the American cigarette companies have followed a different course:

- Rather than relying primarily on exporting American-made cigarettes to supply their growing foreign markets, the companies have shifted to foreign manufacturing, which uses less U.S. tobacco leaf.
- To increase the amount and quality of American-style leaf available, the U.S. tobacco companies and the U.S.-based leaf dealers have turned to foreign sources and have provided direct financial, technical, and material assistance to foreign growers.
- The cigarette companies have increased the amount of foreign tobacco in their American-made cigarettes, with parallel reductions in the amount of U.S. tobacco leaf they buy.

Cigarette Companies Buy Less U.S. Tobacco

As a direct consequence of these American cigarette company decisions, the major cigarette companies now manufacture cigarettes in more than 100 foreign countries. Since 1995, Philip Morris, R.J. Reynolds, and British American Tobacco have purchased or renovated manufacturing plants in Switzerland, Hungary, Tanzania, Poland, Cambodia, Mexico, Romania, Russia, Bulgaria, Ukraine, and China. Accordingly, exports of American-made cigarettes now account for significantly less than one-fourth of all U.S. company brands sold overseas and have declined about 30 percent since 1996. By itself, this drop in cigarette exports has reduced the annual amount of U.S. tobacco leaf used in cigarette manufacturing by about 10 percent in just the past three years.

Nearly 90 percent of all American-style cigarette tobacco (flue-cured and burley) is now grown by foreign farmers in at least 78 countries. And, in the past 20 years the U.S. share of global leaf exports has been cut in half, to less than 11 percent. Without this decline, annual U.S. tobacco exports would be about three times higher than current U.S. tobacco leaf export levels.

Since the U.S. cigarette companies began switching to foreign tobacco, the amount of U.S. leaf in each American-made cigarette has declined by more than 40 percent. In fact, the American cigarette companies currently manufacture *more* cigarettes per year in the United States than they did in the early 1970s, but use about a third *less* U.S. tobacco leaf in the process.

As Cigarette Company Profits Rise, U.S. Tobacco Grower Losses Increase

Because of increased foreign sales and domestic price hikes, the U.S. cigarette companies' revenues and profits have soared since the 1980s. For example, Philip Morris's annual cigarette revenues have more than quadrupled, totaling $42.7 billion in 1998, and its profits from cigarettes have roughly tripled, to $6.5 billion (even after deducting $3.4 billion to cover costs associated with the state tobacco settlements).

At the same time, U.S. tobacco growers' sales, revenues, and profits have stagnated or declined. Not only are tobacco manufacturers using less American tobacco, the growers are

receiving a smaller and smaller piece of the pie. U.S. growers used to receive roughly seven cents of every dollar spent on cigarettes in the United States, but they now receive only two cents or less. Since 1980 the prices charged for cigarettes in the United States by the cigarette companies have increased by more than 270 percent, roughly three times the rate of inflation. But American flue-cured and burley prices have increased by only 19 and 14 percent, respectively, far less than the inflation rate. At the same time, inflation-adjusted farming costs have gone up by nearly 200 percent.

Because of declining purchases, the companies' reduced purchase intentions for the future, and stagnant tobacco leaf export levels, the maximum amount of tobacco U.S. growers are allowed to produce under the industry and grower-financed tobacco price-support program has also declined considerably. From 1997 to 1999, the basic quota for U.S. flue-cured tobacco growers decreased by more than 31 percent. At the same time, the basic quota for U.S. burley tobacco growers declined by more than 35 percent. Both declines include the largest one-year drops in history between 1998 and 1999. The expected reductions in the U.S. cigarette companies' purchase intentions for both flue-cured and burley tobacco in 2000 would further reduce the quotas.

Cigarette Company Actions, Not Smoking Declines, Threaten U.S. Growers

The cigarette companies blame U.S. smoking declines for their reduced purchases of U.S. tobacco leaf (and for their decisions to close U.S. cigarette factories and lay off workers). But that is not the case. From 1997 to 1998, cigarette consumption by U.S. smokers dropped by only about 3 percent, and industry analysts expect that the cigarette companies' recent price hikes, totaling more than 80 cents per pack, will cause a decline in U.S. consumption of about 6 to 10 percent from 1998 to 1999. Because U.S. cigarette tobacco is also used in cigarettes smoked outside the United States, these declines will reduce the overall demand for U.S. cigarette tobacco by only about 4 to 5 percent—a small fraction of the more than 30 percent reduction in U.S. cigarette companies' domestic leaf purchases over the same period.

This disparity is not surprising, given that declines in American consumption have virtually no impact on the number of cigarettes the U.S. companies make in the United States for export overseas. Nor does U.S. consumption influence the number of cigarettes the U.S. companies manufacture overseas for their foreign markets or the amount of foreign-grown tobacco the manufacturers use in their products. In coming years, these factors will continue to play a more significant role in the overall demand for U.S. tobacco leaf than the expected 1 or 2 percent per year change in U.S. smoking levels.

Other Grower Problems on the Horizon

To date, the major influences on the problems facing the American tobacco farmer have been the decisions of the U.S. cigarette companies to grow, process, and manufacture more of their products overseas. Other factors also may contribute to the plight of farmers in the future.

In 1999, R.J. Reynolds (RJR) sold all of its international cigarette factories and operations to Japan Tobacco, including all rights to sell RJR brands overseas. RJR is obligated to sell some American-made cigarettes to Japan Tobacco for international sales over the next three years to the extent they are desired. However, it is not clear whether Japan Tobacco will rely on RJR's U.S. production or begin manufacturing more cigarettes in its

own factories overseas. It is also unclear whether Japan Tobacco will use as much American tobacco in its foreign manufacturing of RJR brands.

The North American Free Trade Agreement (NAFTA) will soon eliminate all tariffs and fees placed on cigarettes or tobacco crossing the border from Mexico into the United States. Some growers believe that the U.S. cigarette companies will take advantage of this by importing more Mexican tobacco to substitute for U.S. leaf and might begin producing cigarettes in Mexico (with less U.S. leaf than American-made cigarettes) for sale in the United States.

China has the capacity to produce massive amounts of low-cost, high-quality cigarette tobacco for export and could soon begin to dominate the global markets. U.S. cigarette companies and leaf dealers already have been helping Chinese tobacco growers to improve the quality of their crops, and China's admission into the World Trade Organization (WTO) could accelerate this process. India, which is already a member of the WTO and a significant exporter of cigarette tobacco, poses a similar threat. The U.S. companies already are active there and are proposing new leaf-improvement initiatives. A recent study found that modest government incentives and investments could quickly increase India's production of high-quality flue-cured and burley tobaccos by 600 percent.

The U.S. cigarette companies and U.S.-based international leaf dealers, among others, are calling for major changes to the American price-support program in order to reduce U.S. tobacco prices. Significant price reductions would increase the global demand for U.S. tobacco leaf (and save the cigarette companies billions of dollars) but also would put many small tobacco growers out of business. They would be able to sell more tobacco, but increased sales would not make up for their revenue losses from price reductions.

Philip Morris, the largest buyer of U.S. tobacco leaf, is trying to persuade some U.S. growers to abandon the current tobacco auction system and enter into direct contracts with the company. Growers fear that such direct contracting would favor larger tobacco farms over smaller ones, make the growers more dependent, put more power and control into the hands of Philip Morris, and ultimately lead to the elimination of the U.S. tobacco price support program. The result would most likely be a much larger and centralized American tobacco-growing industry, controlled by the cigarette companies.

Preparing for an Uncertain Future

The many negative trends—mostly engineered by the U.S. cigarette companies—suggest a difficult future for both the American tobacco growers and their communities. Relief and resources for economic transition might have been forthcoming had 1998 tobacco legislation—the McCain bill—passed the U.S. Congress. This bill would have directed more than $28 billion to help U.S. tobacco growers and cigarette factory workers, their families, and communities adjust to the ongoing decline of U.S. cigarette manufacturing and the reduced purchase of American tobacco. Although the U.S. tobacco manufacturers did not take a position on the farmer provisions in the bill, they vigorously opposed the McCain legislation.

Following the McCain bill's demise, the cigarette companies settled the lawsuits brought against them by the state attorneys general. The settlement did not include any payments to help growers or their communities or offer any other transitional assistance, but subsequently the cigarette companies agreed to provide $5.1 billion (over the next

12 years) to a state-based fund to help tobacco growers and quota holders adjust to declining tobacco production. In addition, some states are directing a portion of their settlement payments to provide various forms of assistance to growers.

These efforts do not address the fundamental problems facing U.S. tobacco growers. They serve as a financial Band-Aid rather than supply any effective strategy to help U.S. growers and their communities move to a more independent, secure, and successful future.

Accordingly, many U.S. growers and their allies have begun to explore new options and strategies. Some of the possibilities that have been raised include:

- Developing state and regional plans to encourage and assist growers to make successful transitions to alternative and supplementary crops.
- Establishing a fund to buy out growers and quota holders who want to leave tobacco farming.
- Creating economic development plans to ensure that tobacco-growing states and communities have both agricultural and off-farm opportunities to ensure their future economic viability.
- Developing alternative, nonharmful uses for tobacco plants, such as bio-engineered medical products.
- Encouraging the use of U.S. over foreign tobacco by requiring that manufacturers list the percentages of each in cigarettes and other tobacco products that are made or sold in the United States.
- Developing and enforcing stronger rules concerning pesticides and other harmful chemicals and additives in tobacco leaf and tobacco products imported into the United States that match the standards for domestic tobacco.
- Creating environmental, labor, and health and safety requirements for tobacco imported into the United States comparable to domestic standards.

This report does not evaluate or endorse any of these options, but it is clear that many U.S. tobacco growers and tobacco-dependent communities have little chance for a successful future unless there is broad debate and action concerning these and other transitional strategies. However, it is likely that many of the proposals to assist U.S. growers and their communities would face considerable opposition from the cigarette companies.

The Growing Alliance Between U.S. Growers and the Public Health Community

Recognizing the sharp conflicts between their own long-term interests and those of the U.S. cigarette companies, many growers have been seeking out new allies, including public health organizations and advocates.

In March 1998, a coalition of more than 40 agricultural, grower, religious, and public health organizations (including the sponsors of this report) released the Core Principles, which outlined shared goals pertaining both to reducing smoking among youth and to assisting U.S. growers and their communities. Among other goals, these Core Principles express support for disclosing the domestic leaf content in tobacco products, Food and Drug Administration authority over *manufactured* tobacco products, the continuance of a U.S. tobacco price support program, and the allocation of new tobacco tax revenues to both advance public health goals and assist tobacco growers and their communities. (See Appendix II for the Core Principles and a list of endorsing organizations and individuals.)

Today, growers and public health organizations are actively working together in the

tobacco states to direct tobacco settlement funds both to reduce tobacco use and to provide transitional aid to growers and tobacco-dependent communities.

The difficulties facing U.S. tobacco growers are great, and their traditional allies, the U.S. cigarette companies, have gone from friend to virtual foe. This betrayal of growers' interests has changed the American tobacco industry and threatens to end family tobacco farms in this country unless new strategies and alliances are developed quickly.

The real threat is that the [tobacco] industry is maneuvering itself to move offshore. Obviously, we can only conclude that they don't care for us.[1]

—C.D. Bryant, Tobacco Grower and Director of Concerned Friends of Tobacco

I hate to say it, but the companies' actions indicate that it's in their long-range plans to put us out of business.[2]

—Jerry Jenkins, Virginia Tobacco Grower and Virginia Farm Bureau Board Member

Introduction

Tobacco farming has played an important role in this nation's history. Many of America's tobacco farm communities and families have roots in tobacco dating back more than 200 years. As U.S. growers often point out, tobacco farming has been more than just a means of paying the bills. It has been a way of life. But that way of life faces serious challenges, with more ahead. If current trends continue, many small, often family-run tobacco farms will be driven out of business, and existing tobacco-dependent communities will suffer accordingly.

How did U.S. tobacco growers reach this crisis situation? The answer requires a careful consideration of past history, current events, and ongoing trends. Misunderstandings are common. Perhaps the most frequent error is the belief that the interests and future prospects of U.S. tobacco growers will rise and fall in unison with the well-being of the U.S. cigarette companies. Today, the exact opposite is closer to the truth. It is the U.S. cigarette companies' success overseas and relentless pursuit of additional profits that have harmed U.S. tobacco growers.

For decades, the major U.S. cigarette companies have referred to themselves, U.S. tobacco growers, the companies' other domestic suppliers, and the workers in their U.S. factories as the United States' tobacco "family." Whenever federal or state government seeks to raise cigarette taxes, implement other measures to reduce smoking, or subject cigarette manufacturing to regulatory scrutiny, the big U.S. companies mobilized their so-called family to oppose them. As noted in an internal Philip Morris memorandum, "local growers have more credibility in legislatures than hired guns."[3] To divert attention away from the harm cigarettes cause and their own misdeeds, the U.S. cigarette companies typically argued that any efforts to reduce smoking would end up hurting small family farmers and blue-collar factory workers who deserve our nation's support.[4] To maintain this effective political strategy, the cigarette companies have worked hard to convince U.S. tobacco growers and workers that their best strategy was to speak with a single voice and rely on the cigarette companies to look out for their best interests.[5]

Meanwhile, thousands of small tobacco farms have been disappearing every year, declining from more than half a million in

the 1950s to fewer than 90,000 now.[6] And since 1977, the number of workers employed in U.S. tobacco factories has declined from over 60,000 to only about 30,000.[7] Purchases of U.S. tobacco leaf are down, farming costs are up, and grower profits have shrunk or disappeared. At the same time, global sales of American brands have soared, and the major cigarette companies have been enjoying enormous worldwide growth and success. Philip Morris's total annual tobacco revenues, for example, have more than quadrupled since 1985, growing from $10.6 billion to more than $42 billion per year.[8]

Rather than rely on U.S. tobacco leaf and U.S.-made cigarettes to supply the rapid, ongoing increase in the worldwide demand for American-style cigarettes, the cigarette companies have shifted their manufacturing to more than 100 overseas factories and have dramatically increased their reliance on foreign tobacco. The amount of U.S. leaf used in each cigarette manufactured in the United States for domestic consumption or export has declined sharply. Exports of U.S.-manufactured cigarettes constitute an increasingly smaller portion of the U.S. companies' overseas sales, and only small amounts of U.S. leaf are being used in the rapidly growing number of U.S. brands being manufactured in foreign countries.

As a result, despite massive increases in the worldwide consumption of American-style cigarettes, demand for U.S. leaf has stagnated. With direct support and financial assistance from the major U.S. cigarette companies and leaf dealers, many more foreign growers can now compete against U.S. growers in the global market for tobacco not only by offering lower prices but by offering high-quality leaf. Now, the U.S. cigarette companies are also demanding major changes to the way tobacco is harvested and marketed in the United States, which would make it even more difficult for many small, family-run tobacco farms to stay in business.

To divert attention from the major role they have played in creating the problems facing U.S. growers, the cigarette companies have used government public health policies, the state tobacco lawsuit settlements, and cigarette tax increases as convenient scapegoats—blaming them for the U.S. smoking declines they say are responsible for the shrinking demand for U.S. tobacco leaf.[9]

But U.S. smoking declines are not to blame. U.S. cigarette consumption has actually declined quite gradually over the past 20 years. From its peak in 1981, U.S. cigarette consumption has declined by about 1.5 percent per year through 1998, on average, and dropped by only about 4 percent from 1993 to 1998.[10] The cigarette companies' price hikes in 1998 and 1999—which currently total more than 80 cents per pack at the factory level—are expected to reduce U.S. cigarette consumption by only about 6 to 10 percent in 1999, with a quick return to more gradual historical rates of decline afterward.[11] In addition, U.S. consumption accounts for less than half of the total demand for U.S. tobacco—and U.S. smoking declines have no effect on the demand for U.S. leaf for overseas use or for cigarettes exported from the United States. Consequently, the gradual smoking declines in the United States over the past decade or two have reduced the overall demand for U.S. tobacco leaf, on average, only by considerably less than 1 percent per year.[12]

If the cigarette companies still used as much U.S.-grown tobacco in the cigarettes they make in the United States as they did in the late 1970s, they would need 50 percent more U.S. tobacco leaf for their U.S. cigarette manufacturing than they actually use today.[13] The real culprit in reduced demand for U.S. tobacco leaf is the increased use of foreign-grown

tobacco in both foreign and domestically manufactured cigarettes and the shift in manufacturing abroad. In addition, the reductions to U.S. cigarette exports caused by the companies' shift to overseas manufacturing since 1996 has reduced the domestic demand for U.S. tobacco leaf by about 7 percent.

Overall, from 1997 to 1999, the U.S. cigarette companies reduced their domestic demand for U.S. tobacco by about 35 percent—at least four times as much as smoking declines alone might warrant—and industry analysts expect the cigarette companies to further reduce their purchases of U.S. leaf in the year 2000.[14]

The facts speak for themselves. Accordingly, this report presents extensive economic data from such sources as the major cigarette companies' annual reports and their filings with the Securities and Exchange Commission, the U.S. Department of Agriculture, and various tobacco industry trade publications, such as *Tobacco Reporter* and *Tobacco International*. It also relies extensively on public statements made by those working in the tobacco industry or associated with it and refers to relevant tobacco industry documents disclosed in the recent tobacco lawsuits.

By presenting these facts, this report offers a clearer picture of how business decisions by the major U.S. cigarette companies have caused and are continuing to cause serious harm to U.S. tobacco growers, their communities, and other workers and businesses that have traditionally relied on the cigarette companies for their economic well-being. We hope that the information presented here will serve as a catalyst for the development and implementation of effective strategies to help U.S. growers and their communities make a successful transition to a more independent and promising future.

Growers and workers are suffering hard times because cigarette companies are importing more than one-third of the tobacco used in U.S.-made cigarettes, producing more cigarettes overseas and automating production to eliminate manufacturing jobs. While encouraging American growers to fight tobacco taxes, major cigarette companies are teaching growers in other countries how to produce tobacco for the U.S. market.[1]

—Former President Jimmy Carter

I. Going Overseas and Leaving U.S. Tobacco Growers Behind

Since the mid-1980s, the major U.S. cigarette companies have dramatically expanded their foreign markets, which has substantially boosted their overall sales and revenues. This move overseas initially increased exports of cigarettes made in the United States, with some corresponding benefits to U.S. tobacco workers and tobacco growers. But these benefits were muted because an increasing share of the cigarettes sold by the U.S. companies in foreign countries has been manufactured overseas. In recent years, foreign manufacturing by the U.S. companies has accelerated, and U.S. cigarette exports, which had been increasing steadily since 1984, have been declining since 1996.[2]

The U.S. cigarette companies have spent billions over the past decade or so to purchase newly privatized foreign cigarette companies, establish joint ventures with existing foreign firms, and build or expand their own overseas manufacturing facilities. In their search for cheaper labor and raw materials, the U.S. cigarette companies have moved beyond just manufacturing their cigarettes in foreign countries. They have also set up tobacco-processing and leaf-development operations in countries ranging from Argentina to Zimbabwe, both on their own and in cooperation with the major U.S. leaf dealers. This is not a matter of the cigarette companies simply taking advantage of lower prices available overseas but of their actively developing new foreign suppliers to displace U.S. growers.

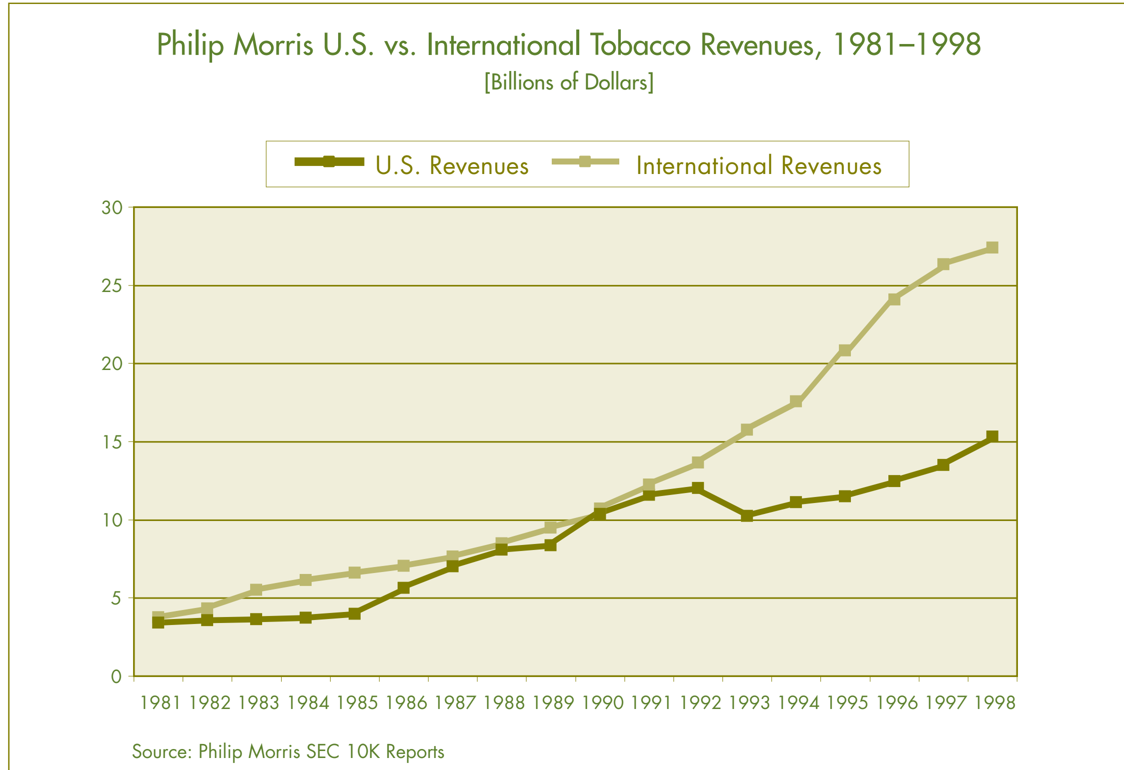
These efforts have helped to prompt large increases in both the quantity and quality of American-style cigarette tobacco available to the cigarette companies from outside the United States. Although the cigarette companies capitalize on the prestige of "American" brands, aggressively market their cigarettes with U.S. images, and label their cigarettes as "American-blend," increasingly large portions of the U.S. cigarette companies' foreign-sold cigarettes are now manufactured overseas with little or no U.S. tobacco leaf. At the same time, U.S. tobacco growers are finding it harder to compete for the business of tobacco manufacturers throughout the world, now that cheaper tobacco of similar quality is more readily available elsewhere.

The U.S. Cigarette Companies' Expanding Foreign Sales and Profits

Philip Morris, the largest U.S. cigarette company, has increased its foreign sales more aggressively and successfully than any other U.S. cigarette company. In 1985, its foreign sales accounted for only about a third of its total cigarette sales revenue and less than 20 percent of its profits. By 1990, Philip Morris's foreign sales produced revenues roughly equal to its domestic sales, but they still accounted for less than 25 percent of the company's total tobacco profits. Now, Philip Morris sells more cigarettes internationally than any other company, with annual foreign sales of more than 716 billion cigarettes (and U.S. sales of about 225 billion). Its foreign sales bring in twice as much revenue as its U.S. sales and account for well over half of its cigarette profits. Philip Morris's Marlboro brand is the biggest seller worldwide, as well as in the United States, and its L&M and Virginia Slims brands, among others, also enjoy large and growing overseas sales.[3] As the chairman and chief executive officer of Philip Morris, Geoffrey Bible, recently said to the companies' stockholders, Philip Morris's international cigarette business is "the true engine of our growth."[4]

Before selling its international operations to Japan Tobacco in early 1999, R.J. Reynolds (RJR; the second-largest U.S. cigarette company) had also dramatically expanded its overseas sales.[5] Since 1995 over 40 percent of its tobacco revenues have come from its foreign sales of such brands as Winston, Camel, and Salem (the world's best-selling menthol cigarette) in 170 different countries. In 1998, RJR sold about 180 billion cigarettes outside the United States (and 110 billion in the United States).[6]

Brown & Williamson (the third-largest U.S. cigarette company) is owned by British American Tobacco (BAT), which is second only to Philip Morris in worldwide cigarette



sales. BAT currently sells U.S. brands such as Kool, Viceroy, Carlton, and Lucky Strike in various foreign markets; and Brown & Williamson directly sells its cigarettes in Japan, Mexico, and South Korea as well as in the United States. In 1998, Brown & Williamson sold 69 billion cigarettes in the United States and 52 billion abroad.[7]

The U.S. cigarette companies' overseas expansion has been aided by a foreign fascination with U.S. culture and the prestige or glamour associated with American-made goods and U.S. brands. As the *Washington Post* reported in 1996, "Throughout the bustling cities of a newly prosperous Asia and the ruined economies of the former Soviet Bloc, the American cigarette is king. It has become the symbol of affluence and sophistication, a statement and an aspiration."[8]

Capitalizing on this advantage, the U.S. companies have been spending millions overseas to sell not only their cigarettes but the American way of life. Besides the globally ubiquitous Marlboro Man, Philip Morris advertises its L&M cigarettes in Senegal as "The *real* American taste!"[9] In Russia, the slogan "Rendezvous with America" is used to sell American-blend cigarettes such as Marlboro, Camel, and Winston.[10] BAT markets a "Hollywood" brand internationally, which was supported by a $2 million ad campaign in Brazil that features Indy 500 racing cars circling the globe.[11] In Poland, Philip Morris encourages potential L&M consumers to "Experience Your California" and raffles off free trips to the state."[12] An investigation of U.S. cigarette company advertising in seven Asian countries similarly found that the U.S. brands "were frequently associated with American or western culture" and that "these brand images were substantially consistent from country to country."[13]

Through this kind of advertising and other marketing practices, the U.S. cigarette companies have successfully prompted many foreign smokers to switch to their so-called "American-blend" cigarettes, which are lighter in taste than those traditionally consumed in many countries.* Although global cigarette consumption is expected to grow by less than 1 percent per year over the next five or ten years, consumption of American-blend cigarettes outside the United States is now estimated to be growing at over 7 percent annually.[14] By the year 2000, an estimated 56 percent of smokers worldwide will smoke American-blend cigarettes.[15] Similarly, industry analysts expect that Philip Morris, already the world's largest cigarette seller, will control an increasingly large share of the international markets, with especially big gains in developing markets.[16] As Geoffrey Bible put it in 1997, "We are still in the foothills when it comes to exploring the full opportunities of many of our new markets."[17]

Yet as the foreign demand for American cigarettes, American brands, and American-style tobacco becomes stronger, the links between America and the cigarettes the U.S. cigarette companies sell overseas become weaker and weaker. Instead of relying on U.S. tobacco and U.S. production to supply the foreign demand for American cigarettes, the U.S. cigarette companies are manufacturing more of their "American" cigarettes in foreign countries with foreign-grown tobacco.

* "American-blend" cigarettes contain approximately 45 to 50 percent flue-cured tobacco (also known as "Virginian" or "bright"), 35 to 40 percent burley tobacco, 15 percent of the darker or oriental tobaccos, and 1 percent "Maryland" tobacco. Foreign-blend cigarettes typically include much larger portions of the darker or oriental tobaccos. [See, e.g., Standard Commercial Corporation, SEC Form 10K-405, June 25, 1998; USDA Economic Research Service, *Tobacco Situation and Outlook Report,* April 1999.]

Increased U.S. Cigarette Company Manufacturing Overseas

In 1963, Philip Morris made its first major tobacco-related foreign acquisition, buying a tobacco manufacturing facility in Switzerland. Since then, Philip Morris has spent billions to build new factories, enter into joint-venture agreements with both private and government cigarette companies, and buy up formerly state-owned factories. As a result, Philip Morris now has manufacturing operations in at least 52 countries. Following similar practices, both RJR International (now owned by Japan Tobacco) and Brown & Williamson's parent company, BAT, own or lease manufacturing facilities or have manufacturing licensing agreements in more than 50 countries as well (for a complete list, see Appendix I).[18] Many of these facilities serve as regional hubs that supply neighboring or even distant countries with the companies' cigarettes.

The companies' investments in foreign manufacturing centers have been especially heavy in recent years. For example:

- In the past five years, Philip Morris has spent over $150 million upgrading its original factory in Switzerland, which can now produce 24.5 billion cigarettes per year. The factory now ships about 14 billion cigarettes to about 60 countries outside Switzerland (a more than 40 percent increase in such shipments since 1991).[19]
- In the early 1990s, Philip Morris, RJR, and BAT purchased three of the four cigarette factories in Hungary, and more than 20 percent of all locally produced cigarettes are now exported to other Eastern European markets.[20]
- In 1995, RJR paid $55 million for a controlling interest in the Tanzanian Cigarette Company, which was the largest single foreign investment in the country since it achieved independence in 1961. Reynolds is rehabilitating the company's main cigarette plant to make it one of the biggest in Africa. Although the Tanzanian cigarette market itself is small, an RJR vice president explained that "[t]his country has the potential to become a major supplier of cigarettes to the Sub-Saharan continent."[21]
- In early 1996, Philip Morris paid $227 million for a 32 percent interest in Poland's biggest cigarette factory, with $145 million more to be paid over the next three years to acquire another 33 percent interest. Philip Morris immediately installed new German machines that can produce 8,000 cigarettes per minute.[22]
- In 1996, Brown & Williamson's parent company, BAT, spent $25 million to modernize its "Liberation Factory" in Cambodia to increase production for both domestic and export markets.[23]
- In July 1997, BAT purchased Mexico's largest cigarette maker, Cigarrera La Moderna (CLM). CLM currently exports cigarettes to Burma, Cambodia, Hong Kong, Laos, the Persian Gulf, and Russia, among others—and, as *Tobacco International* notes, "attractive export prices should further increase exports." Although owned by BAT, CLM also has licensing agreements to produce RJR's Camel, Winston, and Salem brands for international sales. Two weeks before BAT's Mexican purchase, Philip Morris purchased a controlling interest in Mexico's second largest cigarette company, CIGATAM. [24]
- In late 1997, BAT opened a new $70 million cigarette factory near Bucharest, Romania, with annual expected production of four million cigarettes per year, to help compete against the RJR International factory that opened near Bucharest in late 1994.[25]
- In March 1998, Philip Morris and RJR separately announced a new round of invest-

ments in Russia totaling $420 million to build new plants and rehabilitate old ones. These new investments were additions to the over $400 million they had already invested in Russia since 1992.[26] Philip Morris is currently building a new factory in St. Petersburg, and the RJR facility in St. Petersburg can already produce 50 billion cigarettes each year.[27]

- In June 1999, a new cigarette factory owned by a joint venture between a Russian entity and the U.S. Liggett Group (the fifth largest U.S. cigarette company) began operation, with a production capacity of 35 billion cigarettes per year.[28]
- In June 1999, R.J. Reynolds International (now owned by Japan Tobacco) announced the new production of its Camel brand in a factory in Sofia, Bulgaria, with annual output expected to reach 1,500 tons of cigarettes within three years.[29]
- In July 1999, Philip Morris announced that it would be increasing its investment in the Kharkiv Tobacco Factory in Ukraine (a former Soviet republic) by more than $15 million. During the past five years, the company has invested $37 million in the factory, increasing its output from two billion to eleven billion cigarettes per year. With the new Philip Morris funds, the factory plans to start producing locally the Marlboro and L&M brands it currently imports and to further increase its annual production.[30]
- In September 1999, Philip Morris announced that its already-completed $335 million cigarette plant in St. Petersburg, Russia, will start producing a Russian version of its Marlboro brand this winter.[31]

In addition, RJR has built a cigarette factory in China as part of a joint venture with the state-owned China National Tobacco Corporation (CNTC) to produce its Camel and Winston brands for both Chinese and export markets. As part of the deal, RJR provided training as well as technical enhancements. Philip Morris has also signed a number of joint-venture agreements with CNTC to grow tobacco for the production of Marlboros for sale in China and other countries.[32]

The Shift to Foreign Manufacturing and U.S. Cigarette Exports

Despite the U.S. cigarette companies' enormous investments in foreign manufacturing, from 1980 to 1996 they still had to increase their exports of American-made cigarettes in order to meet the growing overseas demand for U.S. brands. In 1985, for example, when Philip Morris began its big push overseas, it exported about 40 billion (or less than 15 percent) of the 275 billion cigarettes it sold in foreign countries. By 1990, Philip Morris had more than doubled its exports to supply about 97 billion cigarettes (or about 26 percent) of its increased foreign sales. The high point was reached in 1995 or 1996. Export figures for 1996 are not publicly available, but in 1995 Philip Morris's exports of over 164 billion cigarettes accounted for 28 percent of its total foreign sales of over 580 billion cigarettes.[33]

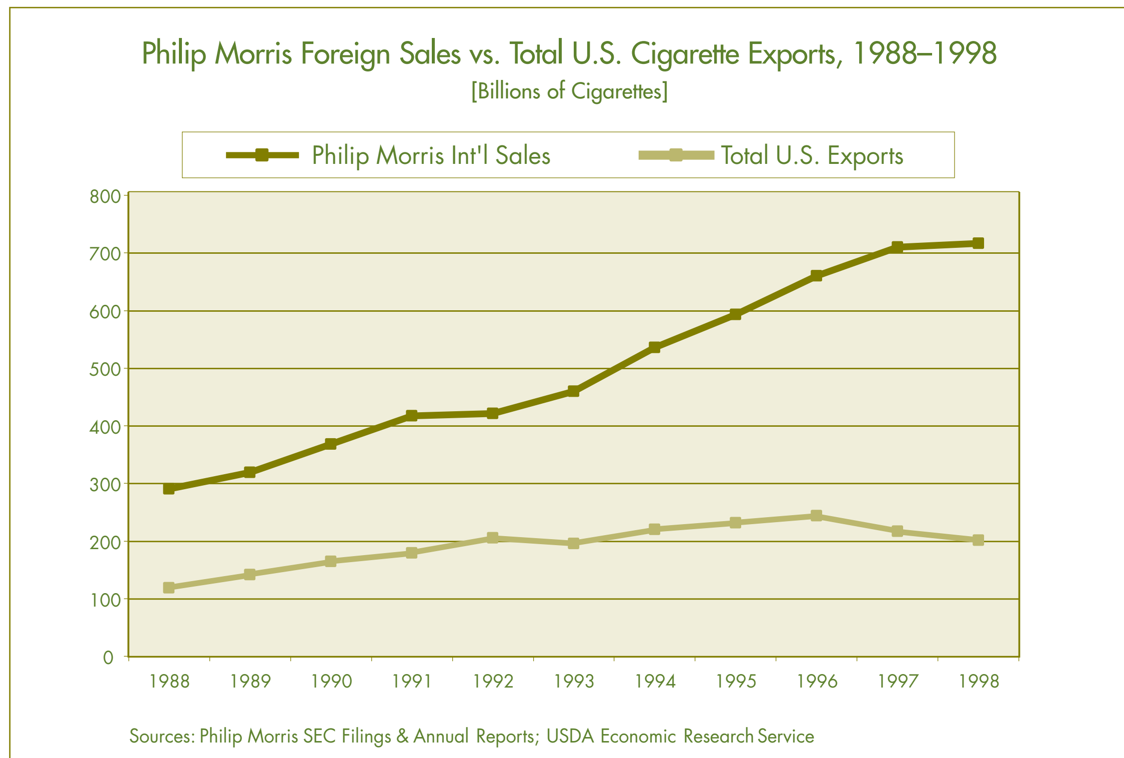
Soon afterward, Philip Morris's expanding foreign manufacturing capacity enabled the company to begin reducing its dependence on U.S. cigarette exports. Although the company's annual reports and its filings with the Securities and Exchange Commission (SEC) have failed to disclose its export totals or percentages since 1995, they do confirm that Philip Morris's overall foreign cigarette sales increased steadily through 1999. Meanwhile, since 1996 U.S. cigarette exports have declined by about 30 percent.[34] Since Philip Morris accounts for the vast majority of cigarette exports from the United States, its cigarette exports must have also declined significantly since 1996, thereby causing

sharp declines in the portion of its foreign sales supplied by its U.S. exports. Comparing just Philip Morris's foreign cigarette sales to the total amount of all cigarettes exported from the United States demonstrates the shrinking role of U.S. cigarette manufacturing in serving the U.S. companies' overseas sales.

From 1993 to 1998, RJR also reduced its use of U.S. exports to supply its foreign cigarette sales, with the export share of its total foreign sales dropping from about 30 percent to 17 percent.[35]

Despite their massive shifts away from U.S. cigarette exports to foreign manufacturing and their use of less American leaf, the U.S. cigarette companies continued to say that their overseas expansion would help U.S. growers and cigarette factory workers as well. Even in late 1997, when the companies' data on declining U.S. exports, increased foreign manufacturing, and reduced use of U.S. tobacco leaf all showed otherwise, a Philip Morris spokesperson made the public claim that "The increasing demand for our cigarettes seems to indicate that there's a bright future for U.S. growers and manufacturers. The whole pie has gotten bigger. We are manufacturing more overseas, but we're also exporting more. The whole business is growing."[36] But if the U.S. companies were still exporting as many cigarettes as they did in 1996, the amount of U.S. tobacco leaf used in American-made cigarettes in 1999 would have been at least 70 million pounds higher (farm-sales weight).[37]

More recently, Philip Morris and the other companies have tried to blame the drops in U.S. cigarette exports (and related plant closings and layoffs) on reduced foreign demand caused by economic problems in the former Soviet Union and, to a lesser extent, in parts of Asia—rather than acknowledge that their increased reliance on foreign manufacturing has reduced their U.S. exports.[38] In February 1999, for example, when Philip Morris announced it was closing its Louisville,



Kentucky, factory, a company spokesperson blamed reduced demand caused by the Asian economic crisis and said that Philip Morris's investments in overseas manufacturing had no bearing on the plant closing.[39] Yet Philip Morris's total foreign sales of cigarettes have been increasing steadily, despite reduced sales in some economically troubled regions, and the companies' U.S. exports have not only failed to keep pace but declined.

At most, the reductions in demand for American brands in economically troubled areas are only temporary disruptions that obscure the more fundamental trends away from exporting American-made cigarettes to manufacturing the American brands overseas. As described above, Philip Morris and the other cigarette companies have for some time been making substantial investments to increase their manufacturing capacity and reduce their reliance on exports in the very same foreign regions where reduced local demand is being blamed for reduced U.S. exports. Philip Morris, for example, has recently announced that it has already accelerated the expansion of its local manufacturing capacity in Eastern Europe so that it will have more foreign manufacturing capacity in place to serve the former Soviet republics well before the end of the year, and will be producing Russian Marlboros in St. Petersburg, Russia, before the end of the winter.[40] Both the Russian Economic Ministry and Tabakprom, the Russian tobacco producers association, have attributed the decline in cigarette imports into Russia to the more than $1 billion invested in Russian tobacco manufacturing since 1990, primarily by foreign firms, and noted that cigarette production in Russia could increase by another 10 to 15 percent in 1999.[41] Similarly, a special report in the August 1999 *Tobacco: World Markets & Trade* stated that because of increases in domestic cigarette production in Russia, imports are expected to fall in 1999 by 31 percent, despite only a 5 percent decline in domestic consumption."[42]

Because of declining exports, the trade surplus from exports of U.S.-made cigarettes has dropped steadily since it peaked in 1994.[43] As foreign production continues to increase, neither the shift away from U.S. exports nor the shrinking of the cigarette trade surplus is likely to stop. While Philip Morris's annual reports and its executives' public statements used to trumpet the fact that its growing cigarette exports were improving the United States' balance of trade, the company no longer provides any data on how many cigarettes it exports.[44] Philip Morris's 1997 and 1998 reports do not even mention exports.[45] Instead, the 1998 annual report states that "we continued to invest in and expand our international manufacturing base," and its corresponding filing with the SEC reports on the company's purchase of manufacturing assets in Indonesia, new production at a facility in Romania, and construction of new manufacturing plants in Russia and Kazakhstan.[46]

Similarly, in December 1997, after announcing some major restructuring of both their international and domestic operations, an RJR spokesperson said that the company planned to rely less on exports and invest more heavily in overseas production.[47] Then, in early 1999, RJR sold all of its foreign operations, including the international rights to all of its brands and trademarks, to Japan Tobacco. [48] RJR still has a three-year contract to provide Japan Tobacco with RJR brands for foreign sale, but it can no longer sell any of its own brands outside the United States or export them to anyone other than Japan Tobacco. Depending on how Japan Tobacco decides to produce the RJR brands it sells overseas, RJR exports from the United States could drop sharply—and the amount of U.S. tobacco leaf in the RJR brands manufactured and sold overseas

NAFTA is very important. Two years ago, no American cigarette companies came here. Last year [1996], they all came here.

—Hector Garcia,
Manager for Tobacco Processing and Exportation, Cigarrera La Moderna (BAT-owned Mexican cigarette company)

The Potential Impact of NAFTA

So far, the U.S. cigarette companies domestically manufacture all of the cigarettes they sell in the United States, but that could change. By 2003, the North American Free Trade Agreement (NAFTA) will permit the unrestricted duty-free importation of Mexican-made cigarettes or Mexican-grown tobacco leaf into the United States, and it has already reduced import tariffs and fees considerably. Philip Morris and Brown & Williamson have made enormous investments to develop their Mexican manufacturing capacity and, with U.S. leaf dealers, are prompting a substantial expansion in the amount of higher-quality cigarette tobacco grown in Mexico. U.S. imports of Mexican tobacco have increased, as have cigarette exports from Mexico to various other foreign countries.[1]

The U.S. cigarette companies could take further advantage of NAFTA by bringing Mexican-made U.S. brand cigarettes over the tariff-free border for sale in the United States, with corresponding declines in their U.S. cigarette production.[2] As *Tobacco International* noted in 1997, "while Mexico exports few cigarettes to the United States now, that might change as the tariff on exports to that country continues to be reduced under the terms of the North American Free Trade Agreement."[3] More recently, a *Tobacco Reporter* article suggested that NAFTA's elimination of import duties might make it worthwhile for U.S. leaf dealers to start processing their U.S. tobacco in Mexico rather than in the United States; and the same kind of cost-savings math applies to U.S. cigarette manufacturing.[4]

Moreover, the U.S. cigarette companies supported NAFTA and lobbied for it. Company documents say they initially supported NAFTA because it would enable the companies to secure savings through duty-free Mexican leaf imports into the United States and to accrue new profits by exporting duty-free cigarettes into Mexico.[5] But very few cigarettes of any kind are currently imported into Mexico from the United States, and the amount of imported Mexican leaf is still quite small. Now that the large investments in Mexican manufacturing capacity by Philip Morris and Brown & Williamson have created a readily available low-cost alternative to their U.S. cigarette factories, the only question is whether and to what extent they will employ it.[6]

could also decline. Although Japan Tobacco has historically been a good customer for exported U.S. leaf, it has much weaker and less direct ties to U.S. tobacco growers than RJR—and Japan Tobacco has no ties at all to workers in RJR's remaining U.S. factories.

Even if the RJR sale to Japan Tobacco does not produce additional shifts to manufacturing U.S. brands overseas, industry analysts expect U.S. cigarette exports to continue declining.[49] Looking at past trends, the *Tobacco Reporter* notes that "U.S. exports to eastern Europe probably will decrease as those countries enter the EU [European Union]."[50] More broadly, a recent study of the world cigarette market that emphasizes the ongoing shift in foreign markets toward American-blend cigarettes notes that local production of internationally sold cigarettes (such as the U.S. companies' brands) will continue to increase in Eastern Europe, the former USSR, Asia, and the Far East.[51] This ongoing expansion of foreign manufacturing will further reduce the United States' declining share of world cigarette production and exports.[52]

U.S. Cigarette Companies' Explanations for Their Shift to Foreign Manufacturing

Philip Morris's Chairman and Chief Executive Officer Geoffrey C. Bible recently tried to defend the company's decision to invest heavily in foreign manufacturing by asserting that in some nations "we are obliged to manufacture locally."[53] A subsequent Philip Morris memorandum to U.S. tobacco growers went even further and said that "many countries" have that requirement.[54] But the 134 countries that are members of the World Trade Organization (WTO) or signatories of the General Agreement on Tariffs and Trade (GATT) have agreed not to prohibit most imports, including U.S. cigarettes; and only a few countries, such as Vietnam and Zimbabwe, prohibit imports of U.S.-made cigarettes.[55] As far back as 1989, Owen C. Smith, a Philip Morris trade lawyer who served as the head of the U.S. Cigarette Export Association, admitted that the only noncommunist countries that banned U.S. imports were Thailand, Syria, and Iran.[56] Nevertheless, in 1998 (prior to RJR's sale of all of its foreign operations to Japan Tobacco), the U.S. cigarette companies—including BAT, the parent company of Brown & Williamson—were manufacturing cigarettes in more than 90 countries that did not prohibit U.S. cigarette imports.[57]

In many cases, the U.S. cigarette companies first penetrate a foreign country's market by importing their cigarettes (either from the United States or other countries where they make cigarettes), but then establish local manufacturing capacity, which either reduces or eliminates the need for imports.[58] In a 1993 speech, for example, Philip Morris Vice President David Milby told growers that "Over the past decade, lower trade barriers, weaker government monopolies and emerging market economies in the former Soviet block more than doubled the available export market for U.S.-made cigarettes from about 40 percent of that market to nearly 90 percent of those five-trillion-plus units."[59] But he did not mention that a significant portion of the cigarettes imported into the region, including U.S. brands, would come not from the United States but from the Netherlands, Germany, the Czech Republic, and Brazil.[60] Nor did Milby mention the massive investments Philip Morris, RJR, and other cigarette companies had already started to make to develop local manufacturing that would dramatically reduce the potentially enormous export market he was highlighting as a coming boon for U.S. growers.

Milby did admit in his speech that a similarly huge cigarette market in Eastern Europe would be largely served by new foreign manufacturing facilities that Philip

Morris was acquiring or licensing, and that most of the cigarettes Philip Morris was selling in the already strong markets in the European Community and Western Europe were manufactured locally. But he did not point out that there were no legal restrictions in any of the countries in these areas that blocked Philip Morris from importing the cigarettes instead.

Given that the U.S. cigarette companies can legally export U.S.-made cigarettes into almost every country in the world, company executives have tried to justify their overseas manufacturing as the only way that the companies can compete given high import tariffs and fees.[61] Although that explanation might hold true for the companies' manufacturing facilities in the handful of countries with very high import duties—such as China and some of the less-developed nations—it fails to explain why the U.S. companies export enormous amounts of cigarettes into foreign countries from equally distant foreign manufacturing hubs rather than from the United States. In some cases, countries levy higher tariffs on imports from distant countries than they do on imports from neighbors, but that does not explain the increased exports from the U.S. companies' factories in the Netherlands, Switzerland, or Brazil to countries outside their respective regions.[62]

In addition, the more industrialized or developed countries that have signed the GATT and are members of the WTO typically have relatively low import duties; and the WTO and GATT are reducing import fees for developed and undeveloped countries alike.[63] Yet the U.S. cigarette companies have been serving the developed countries covered by GATT and WTO largely through foreign manufacturing rather than through exports from the United States, and their U.S. exports currently account for less than a third of their total foreign sales.[64] In the mid- to late 1980s, for example, the Office of the U.S. Trade Representative responded to U.S. cigarette company complaints and applied international trade treaties to eliminate cigarette import restrictions in Japan, South Korea, Thailand, and Taiwan—but U.S. cigarette companies still manufactured cigarettes in each of these countries in 1998 and 1999.[65] Similarly, Philip Morris and Brown & Williamson made large new investments in Mexican manufacturing capacity after the North American Free Trade Agreement (NAFTA) was passed, and total U.S. cigarette exports into Mexico declined from 1996 to 1998 by more than 85 percent.[66]

The relative insignificance of import duties and fees in the cigarette companies' decisions to establish foreign manufacturing is underscored by the fact that Philip Morris International's five-year plan for 1994–1998 does not mention import restrictions of fees either as a major problem or even as one of its costs of doing business.[67]

It is also revealing that in several instances the U.S. cigarette companies have rapidly replaced their cigarette imports with local production as soon as prohibitions against such local manufacturing by non-national corporations were removed. For example, when such restrictions fell in the Soviet bloc and Turkey, the U.S. cigarette companies quickly moved in to establish local manufacturing capacity, which ultimately reduced their imports.[68] In fact, Philip Morris played a key role in opening up Turkey to foreign manufacturing and now operates a factory there that pumps out as many as 12,000 Marlboros and other Philip Morris cigarettes each minute.[69] When it remains difficult or impossible for the U.S. cigarette companies to establish their own factories in a country, they often still avoid relying on imports by entering into joint ventures with the local manu-

facturers or license them to make U.S. brands for local sale, as they have done in China, Japan, Austria, and South Korea.[70]

Even when there are no cost savings from manufacturing locally instead of exporting cigarettes from the United States, the U.S. cigarette companies prefer to establish local manufacturing facilities in order to increase their economic and political leverage in the country. Speaking of a planned acquisition in Poland, for example, Philip Morris International's five-year plan for 1994–1998 states that "This was a strategic investment to provide a basis for active participation when the political and economic situation improves."[71]

Expanded Foreign Tobacco Processing to Supply the U.S. Cigarette Companies' Increased Foreign Manufacturing

To supply their growing base of foreign manufacturing facilities, the U.S. cigarette companies have also made major efforts to increase and improve both the growing and subsequent processing of foreign tobacco leaf. As U.S. cigarette companies increased their overseas manufacturing capacity, the major leaf dealers quickly followed, setting up leaf procurement and processing facilities near the new factories. Today, the three biggest international leaf dealers—Universal, Dimon, and Standard Commercial (which are all U.S.-based companies)—operate in dozens of countries on five different continents (for a complete list, see Appendix I).[72] Among the many new foreign tobacco-leaf-processing facilities supported by the major cigarette companies and leaf dealers are the following:

- In the early 1990s, Philip Morris and Universal purchased the largest tobacco processing company in Kazakhstan from the government.[73]
- In 1995, Philip Morris opened a leaf-processing facility in Malaysia, which soon began exporting to factories in other Asian markets. The facility can process about 20,000 tons of tobacco a year. According to a story in the trade journal *Tobacco International*, many of the plant's employees have been trained at Philip Morris factories in Australia and the United States. That same story quotes Peter L. Barnes, president of Philip Morris Asia, as saying, "This plant is both a symbol and an example of Philip Morris's leadership in tobacco manufacturing, processing, and blending…in training and technology transfer; in developing exports for Malaysia."[74]
- In December 1996, BAT's Brazilian subsidiary "inaugurated a new 1.2 million square foot leaf processing facility, the largest of its kind." The plant is capable of processing up to 120,000 tons of leaf per year. During the first year, it was expected to process some 90,000 tons, mostly for export.[75]
- In 1997, BAT officials first announced plans to build a leaf-processing plant in Cambodia; and then announced in 1999 a $12.5 million plan to quadruple its output to four metric tons per hour.[76]
- In Mexico, BAT-owned CLM has an agreement with the Intabex Group to supply Mexican burley to the international market. Intabex pre-finances the production of the burley, which is processed at the CLM Azteca facility before being exported.[77]
- In 1997, rival leaf dealers Standard Commercial and Universal joined forces in Tanzania to invest in expanding a leaf-processing factory. Their goal is to promote greater leaf exports from Tanzania to "better fulfill the product requirements of their international customers." Standard CEO Robert E. Harrison says that Tanzania "is

an important source of filler-style tobacco for many of our customers, particularly those in Europe. We foresee our involvement as contributing to a more stable and reliable source of supply." [78]

- In late 1998, Dimon opened its own "state-of-the-art" tobacco-processing plant in Tanzania. Dimon Chairman Claude Owen Jr. is quoted in *Tobacco Reporter* as saying that Tanzania "has the cost structure and the economic potential for the long term to be a very good tobacco producer." [79]
- In December 1998, Standard Commercial opened the first leaf-processing factory in India with the capacity to produce tobacco that meets international standards. CEO Robert Harrison noted that "with pressure on the industry and increasing demand for lower cost components…we see great potential to increase exports from China and India, providing a continuity of supply to a larger number of customers."[80]
- In August 1999, Standard Commercial opened a new processing plant in the St. Petersburg region of Russia that aims to process 20,000 metric tons per year.[81]

These new, foreign processing facilities provide the major cigarette manufacturers with foreign-grown flue-cured and burley tobaccos that are less expensive than the genuine American versions. As Robert A. Sheets, the vice president and chief financial officer of Standard Commercial, has noted, "the market is growing in the low-priced categories. In the last part of fiscal year 1998, and the first part of 1999, we have been opening facilities throughout the world that put us in a very strong position to meet the demand in that area."[82] Indeed, Standard's president subsequently reported that the company's "processing investments in key sourcing areas are coming on line and have been well received by our cigarette manufacturing customers."[83]

Increased Foreign Tobacco Growing to Supply the U.S. Cigarette Companies' Foreign Expansion

The U.S. cigarette companies not only take full advantage of available foreign-grown tobacco but also have made extensive investments to increase the quality and quantity of foreign-grown American-style cigarette tobaccos. In many countries, the U.S. cigarette companies directly support and assist the local tobacco growers, and elsewhere they work with the major leaf dealers to develop and expand foreign tobacco supplies for "American" cigarettes. As a result, more of the tobacco in U.S. brands does not come from the United States but is being grown in countries such as Argentina, Brazil, Chile, Malawi, and Zimbabwe. In India, for example, an official with the state-owned cigarette company notes that "Both Philip Morris and RJR are buying greater quantities of tobacco to export."[84]

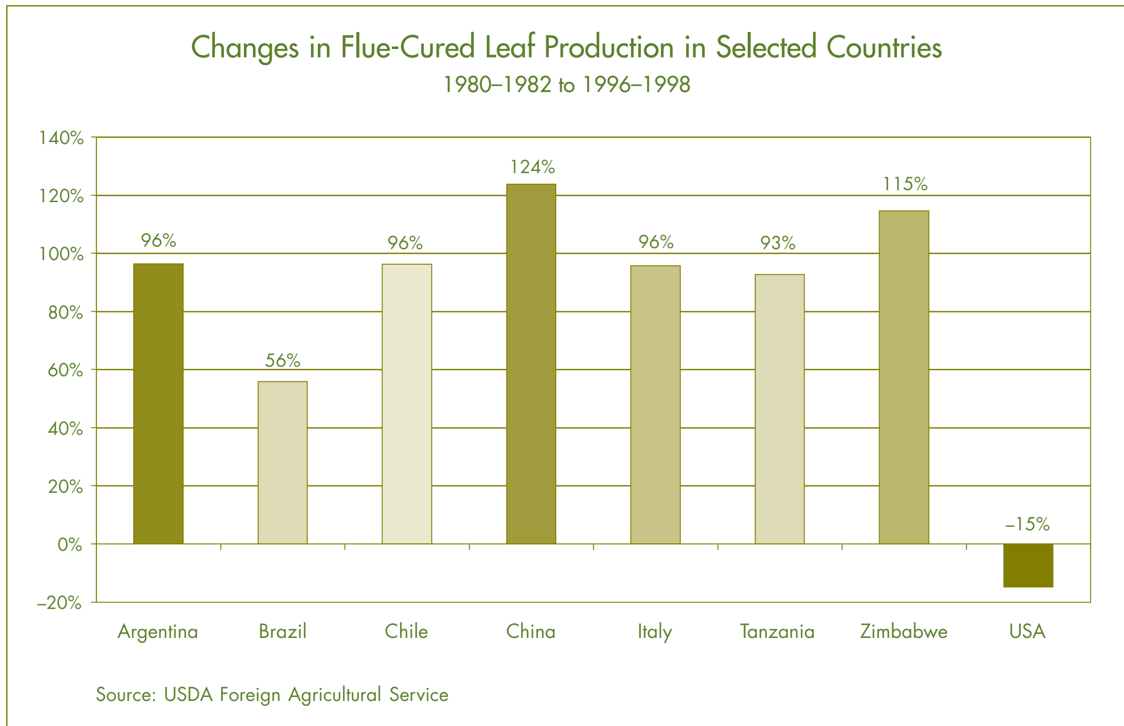
U.S. Cigarette Company Support of Foreign Tobacco Growers

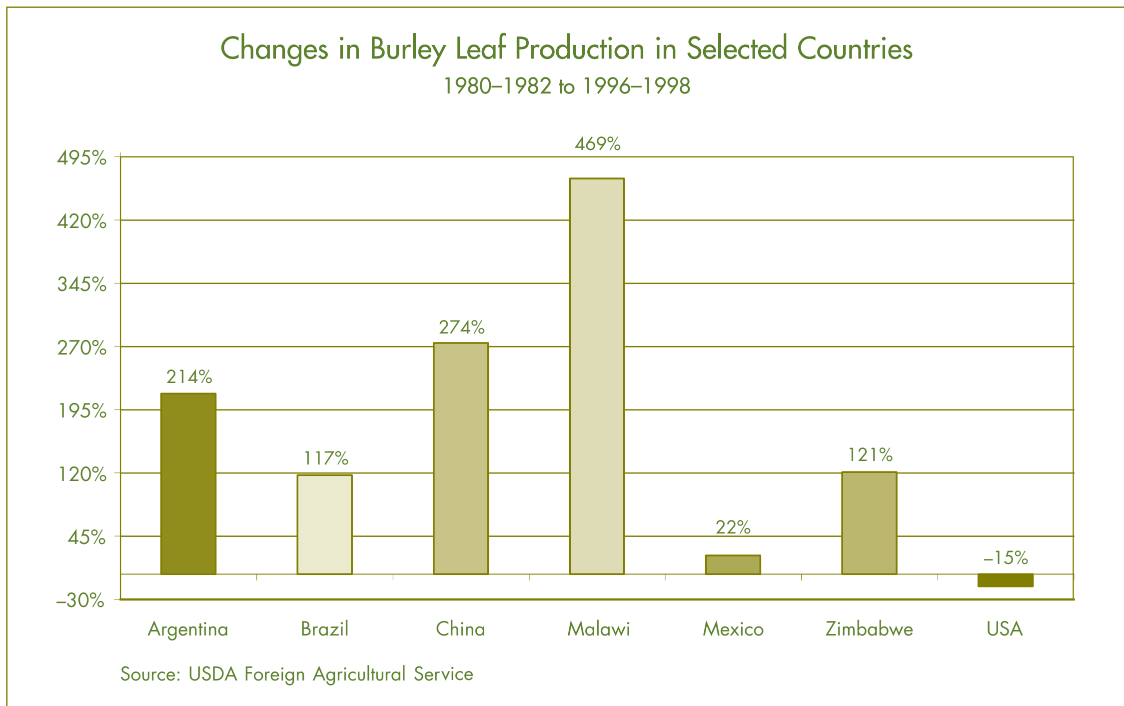
In 1992, BAT, the parent company of Brown & Williamson, stated: "Wherever it is agriculturally feasible, BAT encourages the development of tobacco growing by independent farmers by providing seed, fertilizers, and technical farming advice." More specifically, BAT said that it was providing advice and assistance to more than 500,000 small farmers throughout the world and had caused tobacco to be grown in 24 countries, with a special focus on expanding and improving flue-cured and burley production.[85]

While the other major cigarette companies are doing much the same, such admissions are rare; and only the cigarette companies know all the places they are working to help foreign tobacco growers produce the American-style cigarette tobacco. But the fol-

lowing examples—from reports published in *Tobacco Reporter*, *Tobacco International,* and other sources—provide some idea of the extent and nature of the U.S. companies' overseas efforts.

- In 1995, RJR signed a joint-venture agreement with the Vietnamese government to export commercial-quality tobacco to countries such as Canada and Germany. The company teaches growers how to grow and cure tobacco and gives them technical and financial support, including funding for fertilizers, pesticides, and other infrastructure. According to the trade journal *Tobacco Reporter*, the project included 8,000 growers in 1998, more than double the number in 1997. In December 1997, this RJR project was the first to export commercial quality tobacco from Vietnam when it sold 365 tons of burley and flue-cured tobacco to Canada and Germany.[86]
- In 1996, Philip Morris established a growers' fund in southern Poland to improve the quality of Polish tobacco. Eighteen thousand growers benefit from modern leaf-drying facilities, fertilizers, and new seed strains, and the company has signed contracts with these growers to deliver set quantities of light tobaccos for a minimum of three years.[87] Meanwhile, Brown & Williamson's parent company, BAT, has launched a project to increase the production of Virginia and burley tobaccos. The company has set aside $3 million for no-interest loans to Polish growers and also provides them with technical assistance and farm machinery.[88]
- In 1996, the Hungarian Tobacco Industry Association, which includes Philip Morris and RJR, established a fund to support Hungarian tobacco growers in the hope that the country's tobacco imports could be reduced. The companies initiated the fund with a grant of $1.6 million; and Philip Morris has reportedly provided assistance to Hungarian growers on its own.[89]
- Since 1996, Brown & Williamson's parent company BAT has been helping Cambodian tobacco growers. According to BAT Corporate Affairs Manager Carrick Graham, BAT is "reducing reliance on imported tobacco by investing and building up the quality and expertise of the farmers here in Cambodia.…We brought international tobacco buyers to Cambodia to look at the crop and they're really interested in developing it further."[90]
- In Russia, Philip Morris and Universal jointly operate one of the country's largest leaf-growing operations. Activities include the financing, growing, and sale of leaf, as well as the introduction of new "American-blend" plant varieties, including Virginia and burley. [91]
- RJR is "actively involved in tobacco cultivation activities with fully owned agronomy operations in Vietnam and Turkey and a joint venture in China," according to the company's filing with the SEC.[92] In Azerbaijan, RJR has named Universal "as a strategic partner to develop and boost local leaf production, as well as to investigate the feasibility of growing American leaf varieties." [93]
- In a 1998 description of its Asian Pacific activities, BAT stated: "In addition to developing state of the art manufacturing technology in our factories throughout the region, we are actively involved in the development and growth of tobacco leaf in Indonesia, Malaysia, China and Cambodia."[94]
- In early 1999, Philip Morris proposed to India's Foreign Investment Promotion Board that it set up a wholly owned subsidiary in India to improve tobacco leaf quality and yield, set up a tobacco processing plant using proprietary technology, and provide other services to promote


Changes in Flue-Cured Leaf Production in Selected Countries
1980–1982 to 1996–1998
140%
120%
100%
80%
60%
40%
20%
0%
–20%
96%
56%
96%
124%
96%
93%
115%
–15%
Argentina
Brazil
Chile
China
Italy
Tanzania
Zimbabwe
USA
Source: USDA Foreign Agricultural Service


Changes in Burley Leaf Production in Selected Countries
1980–1982 to 1996–1998
495%
420%
345%
270%
195%
120%
45%
–30%
214%
117%
274%
469%
22%
121%
–15%
Argentina
Brazil
China
Malawi
Mexico
Zimbabwe
USA
Source: USDA Foreign Agricultural Service

Indian tobacco and cigarette production.[95] India is already the ninth largest tobacco exporter in the world and annually exports over 130 million tons of flue-cured tobacco and about 10 million tons of burley.[96] A recent report by the Indian Tobacco Institute estimated that within five years India could increase its tobacco exports by more than 600 percent if the government would take some simple steps to encourage flue-cured and burley tobacco cultivation there.[97]

- In September 1999, BAT's Mexico subsidiary Cigarrera La Moderna (CLM) announced that it would be providing $40 million next year to promote Mexican tobacco growing.[98]
- In October 1999, Philip Morris announced that it had started working with Thailand's Siam Tobacco Export Corporation to improve the quality of Thai tobacco, in a program involving more than 4,000 farmers there. At the same time, Philip Morris announced a similar program in Malaysia, including the construction of a new tobacco processing plant.[99]

Besides developing foreign leaf production, the U.S. cigarette companies also appear to be supporting foreign growers and buying foreign leaf to develop useful allies in their ongoing battle against foreign countries' efforts to prevent and reduce smoking. The documents from a major 1985 Philip Morris International meeting on smoking and health issues, for example, detail the company's efforts to "enlist the help of our *natural allies* such as the trade and growers" (emphasis in original) to oppose tobacco tax increases and other antismoking measures. The documents state that "we have already helped organize growers in a number of countries" and "we intend to do more on tax and health issues with the growers in Europe."[100]

Leaf-Dealer Support for Foreign Tobacco Growers

The cigarette companies' projects are only a part of the ongoing effort to increase foreign production of high-quality American-style tobaccos. Other work is done by the U.S.-based international leaf dealer companies, usually in close cooperation with the major cigarette companies. Dimon, for example, plans to "increase the Company's operations in low-cost tobacco growing regions" in order to achieve its "primary business objective…[which is to]…capitalize on the growth in worldwide consumption of American blend cigarettes by becoming the preferred low-cost supplier of leaf tobacco to the large multinational manufacturers of American blend cigarettes."[101]

With cigarette company input, the leaf dealers determine where, how much, and what kind of tobacco will be produced overseas. In some countries the leaf companies receive down payments from American cigarette companies to deliver a set amount of leaf and then use that down payment to provide cash advances to growers in countries, such as Brazil, thereby helping to finance growers there without putting their own funds at risk.[102]

In many countries, the leaf dealers go beyond financial support and directly subsidize tobacco production through education, training, and technological modernization. Determining the exact level and character of the support the leaf companies provide to growers in the many foreign countries where they operate is impossible, but the following examples demonstrate how far they will go in order to encourage the overseas production of flue-cured and burley tobaccos for American-blend cigarettes.

- According to Dimon's filings with the U.S. Securities and Exchange Commission, it currently "pre-finances tobacco crops in…countries including Argentina, Brazil,

China is another cloud looming on the [U.S.] growers' stormy horizon.[1]
—Richmond Times-Dispatch

The China Question

China already produces enormous amounts of flue-cured tobacco more cheaply than anyone else in the world—and it could ultimately put a lot of other tobacco producers out of business. From 1997 to 1998, China's leaf exports increased by more than 28 percent, to more than 200 million tons of mostly Virginia flue-cured—and the U.S. and other international cigarette companies, along with the U.S.-based international leaf dealers, are continuing to work with Chinese growers to increase their yields and improve quality.[2]

In 1995, for example, Philip Morris signed a long-term agreement with the Chinese government designed to increase the production of flue-cured, burley, and oriental tobaccos for use in the company's Marlboro cigarettes, and sent 12 American experts to provide guidance to local growers.[3] In December 1998, Standard Commercial commissioned the first state-of-the-art processing facility in China's Guizhou province, and the leaf dealer just recently announced that it will design and install a new leaf-threshing line in China's Yunnan province. Overall, Standard will soon have four facilities in China to process tobacco for both the Chinese and export markets.[4] In each case, Standard supplies both machinery and the "expertise in the growing, grading and selection of export quality leaf tobacco."[5] Meanwhile, Universal manages yet another new leaf-processing plant in China under an agreement that designates a minimum of 70 percent of the facility's output for export. "I can't tell you how much money has been put into this," says Universal's project manager, "but it is a lot."[6]

In addition, Japan Tobacco—which has been a major buyer of U.S. tobacco leaf exports and now also controls virtually all production and sales of RJR's brands outside the United States—has developed close business relations with the Chinese tobacco industry and will soon begin manufacturing Japan Tobacco brands in China using Chinese tobacco.[7] As Chinese quality improves, Japan Tobacco could begin increasing the amount of Chinese tobacco it uses, both in China and elsewhere, with corresponding reductions to its purchases of U.S. exports.

Once China becomes a full member of the World Trade Organization (WTO), it may have to open its borders to both cigarette and tobacco imports, which currently face significant trade barriers. Given the massive size of the Chinese market (Chinese smokers annually consume more than 1.5 *trillion* cigarettes), opening it to imports could have a major impact. A recent report by the U.S. International Trade Commission, for example, found that the tariff changes China was offering early on in exchange for WTO membership would, at least initially, significantly increase U.S. tobacco exports into China, with "beverage and tobacco" sector exports more than doubling.[8] At the same time, however, WTO membership would likely open China's doors both to increased manufacturing of U.S. brands in China and to more U.S. and multinational cigarette company and leaf dealer investments to improve the quality of Chinese tobacco leaf.[9]

the Dominican Republic, Indonesia and Tanzania by making cash advances to growers prior to and during the growing season" and also advances "substantial sums or guaranteed local loans or lines of credit in substantial amounts for the purchase of tobacco from growers."[103]

- In Brazil, Dimon spends about $100 million a year financing tobacco growers.[104] The company provides tobacco growers with fertilizer and other inputs, agrees to purchase their entire crop, and in some cases finances the construction of curing barns. Dimon's agronomists also "maintain frequent contact with growers prior to and during the growing and curing seasons to provide technical assistance to improve the quality and yield of the crop."[105]
- In Tanzania, Dimon has contracts with more than 30,000 Tanzanian growers—providing them with seed, fertilizer, and chemicals—and has a training program "to teach growers more efficient ways to grow tobacco," according to Dimon's Tanzania representative.[106] Dimon will ultimately invest upwards of $35 million in Tanzania; and the company enthusiastically notes that "due to the vast areas of undeveloped land suitable for production, Dimon's growth in Tanzania has unlimited potential."[107]
- In the former Soviet Union, Dimon is concentrating its efforts in those republics that have the capacity to export tobacco. As Dimon's Chief Executive Officer Claude Owen Jr. told *Tobacco Reporter*, tobacco growers in those republics "need inputs, they need cash….That's what we're doing….It sounds simple, but it's a fundamental fact that the grower has to be paid if he's going to continue to grow tobacco."[108]
- In Vietnam, Dimon is helping the government develop new crop varieties for what it hopes will be a growing export market. "Because of cheap labor, Vietnam can sell the majority of its tobacco for less than [$1.36 per pound]," says Dimon's representative. "When the [U.S.] trade barriers are removed, we will be extremely competitive."[109]

According to U.S.-based Universal's SEC filings, "In a number of countries, including Argentina, Brazil, Hungary, Italy, Mexico and Tanzania, Universal contracts directly with tobacco growers or groups of growers, in some cases before harvest, and thereby takes the risk that the delivered quality and quantity will not meet market requirements." In some countries, the company also provides "agronomy services and crop advances for seed, fertilizer and other supplies…[and has] advanced substantial sums, has guaranteed local loans or has guaranteed lines of credit in substantial amounts for the purchase of tobacco."[110] In Brazil, for example, Universal contracts with some 35,000 growers, providing them with no-interest loans of seed and fertilizer, offering technical assistance, guaranteeing and paying the interest on their bank loans, and guaranteeing the purchase of their crop.[111] They also provide growers with up-to-date information on new growing techniques and timber harvesting, as well as weather forecasts. Universal estimates that it spends about $100 million a year financing Brazilian growers. As one Universal agronomist working in Brazil notes, "The industry supplies the material, the grower does the work."[112]

Standard Commercial also provides cash advances or finances the purchase of fertilizer and other supplies for tobacco growers in many countries, including Argentina, Brazil, Turkey, and Thailand. In 1998, the company spent $53.2 million on these types of payments. Standard is particularly active in China, where it has provided agronomy services and funded projects since 1981 and expects to increase tobacco production further "through strategic alliances with the

Chinese government."[113] One of the goals of Standard's China projects is to develop a "Chinese blend" that will have all the components of the American-blend cigarettes.[114] As CEO Robert Harrison stated in a 1998 letter to shareholders, "The combination of India, Tanzania, and China positions us advantageously in some of the largest low-production-cost markets in the world; [sic] a position that should become increasingly important as our customers continue to look for ways to reduce their product costs." [115]

There is no evidence that these efforts to promote the foreign production of high-quality and lower-cost "American-blend" tobaccos are likely to slow down. In a speech in December 1998 at TABExpo 98, a yearly international tobacco industry meeting, Allen King, CEO of Universal, stated that to meet the needs of a changing market for burley and flue-cured tobacco, the industry must expand production in new leaf sources and less traditional regions through a new "strategic partnership" between the major cigarette manufacturers and leaf dealers.[116] In an earlier speech, King had pointed out that Africa is poised for enormous gains because "there is vast acreage suitable for tobacco production and generally enough labor to support major production growth."[117]

Standard Commercial's 1998 filing with the SEC states:

> "As cigarette manufacturers expand their global operations, [Standard Commercial] believes there will be increased demand for local sources of leaf tobacco and local tobacco processing facilities, primarily due to the semi-perishable nature of unprocessed leaf tobacco and the existence of domestic tobacco content laws in certain countries. [Standard Commercial] also believes that the international expansion of cigarette manufacturers will cause these manufacturers to place greater reliance on the services of financially strong leaf tobacco merchants with the ability to source and process tobacco on a global basis and to help develop higher quality local tobacco sources."[118]

In contrast, many U.S. tobacco growers have had to take out loans or invest large sums of their own money to maintain or modernize their equipment. As Kentucky tobacco grower Emily Mattingly notes, "The thing that aggravates us more than anything is that they go [overseas] and they foot the bills for their barns, they buy their equipment, and they pay for their fertilizer. Well, if they did that for me, I'd sell [my tobacco for less] too."[119] Similarly, Virginia tobacco grower Bobby Wilkerson observes, "Dimon is right here in my front door," he says, "and they've taught the Brazilians to grow tobacco because of the cheaper price. That has bothered me for a long time. They're spending millions of U.S. dollars basically to drive us out of business."[120] In October 1998, Rick Apple, a tobacco grower and former president of the North Carolina Tobacco Growers' Association, asked, "If the cigarette companies care about American tobacco growers, why aren't they offering these deals to us?"[121]

Although the U.S. tobacco support program's price guarantees and the actual prices for U.S. tobacco substantially declined in the mid-1980s, the U.S. cigarette companies still decided to support their new foreign sales by increasing both their overseas manufacturing and their use of foreign-grown tobacco, instead of relying on U.S. leaf.[122] Because the cigarette companies took that path, it is now an entirely different world of tobacco production.

It's a very difficult situation when your #1 customer is also your #1 competitor.[1]

—Rick Apple, Past President of the North Carolina Tobacco Growers Association

II. Changing the Mix in the U.S. and Global Tobacco Markets

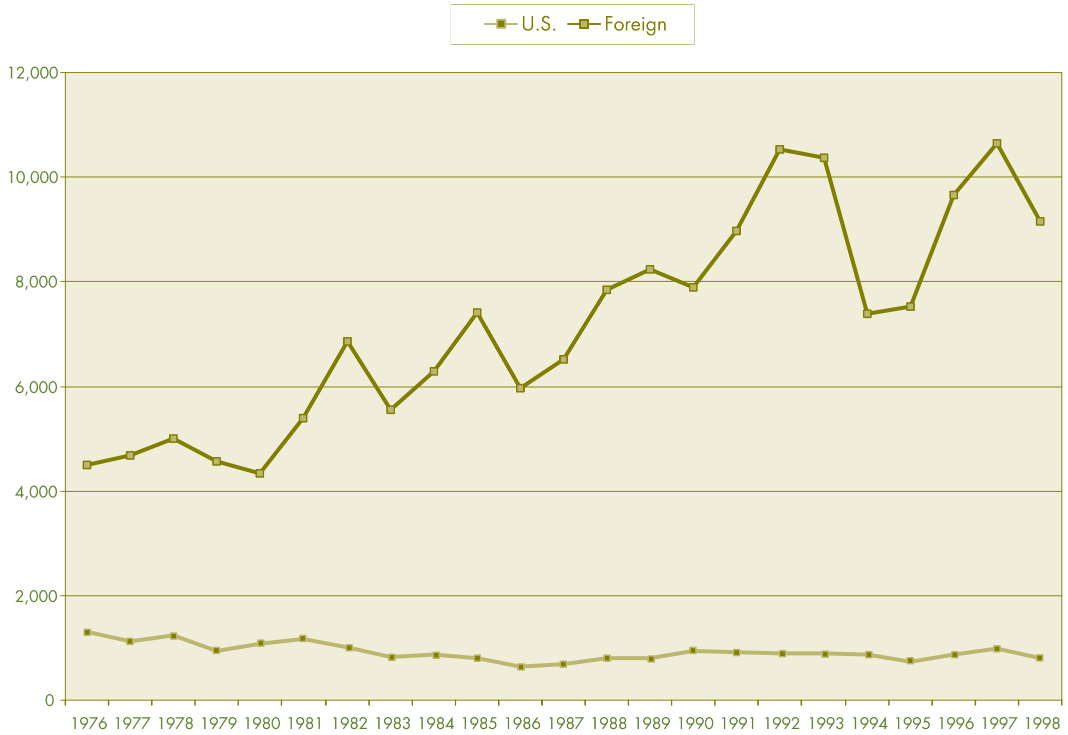
Although worldwide manufacturing and sales of American-blend cigarettes are at record-high levels, U.S. tobacco growers are losing their share of both the domestic and international markets and have been unable to maintain historical levels of either exports or domestic sales.

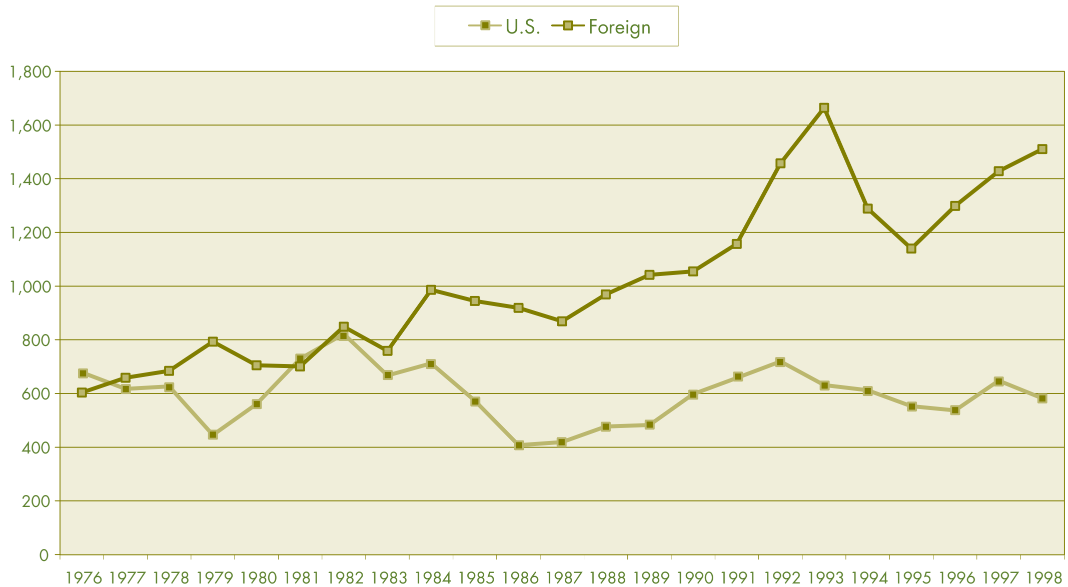
The Rise of Foreign-Grown Tobacco for American-Blend Cigarettes

Worldwide, at least 78 countries now grow flue-cured tobacco and at least 57 grow burley tobacco, the two major tobaccos in American-blend cigarettes that have traditionally come from U.S. tobacco growers.[2] In recent issues of *Tobacco International* and *Tobacco Reporter,* Dimon offers "leaf tobacco from all corners of the globe," while Standard talks about "flexing a buying power that encompasses all tobacco growing areas across the globe." An Italian leaf-exporting company offers burley and Virginia Bright, and a Greek leaf exporter offers complete service for all your "Virginia and Burley" requirements.[3] And in 1998, Turkey, one of the major world suppliers of oriental tobacco leaf, exported both flue-cured and burley tobaccos for the first time.[4]

Annual flue-cured production in the United States has declined since the late 1970s and early 1980s, while production of burley has stayed roughly the same. But foreign production of both of these American-style tobaccos has more than doubled. As recently as 1981, the United States produced more burley tobacco than the rest of the world combined, but foreign countries now produce more than two and a half times as much burley than the United States; and foreign tobacco farmers now produce more than 10 times as much flue-cured as U.S. growers.[5]

Since the early 1980s, for example, tobacco production in Argentina and China has increased by more than 80 percent, and Malawi's has more than doubled.[6] According to estimates published in the tobacco trade journal *Tobacco International,* the developing countries will soon account for almost 80 percent of the world's tobacco production, compared with just 50 percent in the 1960s.[7] Not surprisingly, the U.S. share of global tobacco leaf production has declined sharply from about 25 percent in the early 1960s, recently hovering around the 10 percent mark.[8] If China (the top tobacco-producing country) and others had not recently curtailed their





Source: USDA Economic Research Service & Foreign Agricultural Service

tobacco production as part of efforts to improve the quality of their crop, the U.S. share of total global production would be even smaller.[9]

While U.S. growers still have a competitive advantage in terms of crop quality, that advantage has shrunk considerably. As early as 1985, internal Philip Morris documents noted that while global production was rapidly increasing, "[m]ost producing countries of the world continue to emphasize quality over quantity."[10] With the assistance of the U.S. cigarette and leaf dealer companies, the quality of foreign-grown tobacco is now beginning to rival that of U.S. tobacco.[11] The U.S. Congressional Research Service observed in 1998 that "with assistance from cigarette manufacturers, growers in especially Brazil, Zimbabwe, Malawi, and Argentina have improved the quality of their tobacco and expanded production."[12] As one North Carolina tobacco grower puts it, the companies "are going for the cheaper tobacco, which is almost as good as ours. [American] growers have been led to believe that we still have superior quality…[but] their quality is so close to ours now that the companies are able to interchange our tobacco with theirs in cigarettes and it goes unnoticed."[13]

With much lower labor and production costs, foreign growers can sell their high-quality leaf at a fraction of U.S. prices. Data from invoices examined at U.S. ports of entry in 1997 showed that imported tobacco averaged $1.70 per pound, compared with export prices of $2.90 per pound for U.S. leaf.[14] This price disparity could increase. As Raul Denardi, president of Dimon of Brazil observes, "If I were an American farmer, I wouldn't be afraid of Brazil. What [I would be] afraid of is the African countries and India," undeveloped areas where the average wage can be as little as one dollar per day.[15]

Because of these developments, James Starkey, Universal's vice president, sees that U.S. tobacco is becoming "substitutable" by foreign leaf. "The more important the price of the final product," Starkey tells *Tobacco International*, "the more a customer will substitute its U.S. leaf purchases…. Price continues to be a major issue, or the major issue."[16] As another leaf dealer executive puts it, "Tobacco used to be savored for its quality, but now…it boils down to price.[17]

Reduced U.S. Leaf Exports

The U.S. cigarette companies point out that they are the largest customers for U.S. tobacco leaf overseas, and they take much of the credit for the increased global demand for American-style cigarettes and tobacco. As Owen Smith, then president of Philip Morris International, stated in a speech to U.S. tobacco growers in 1996:

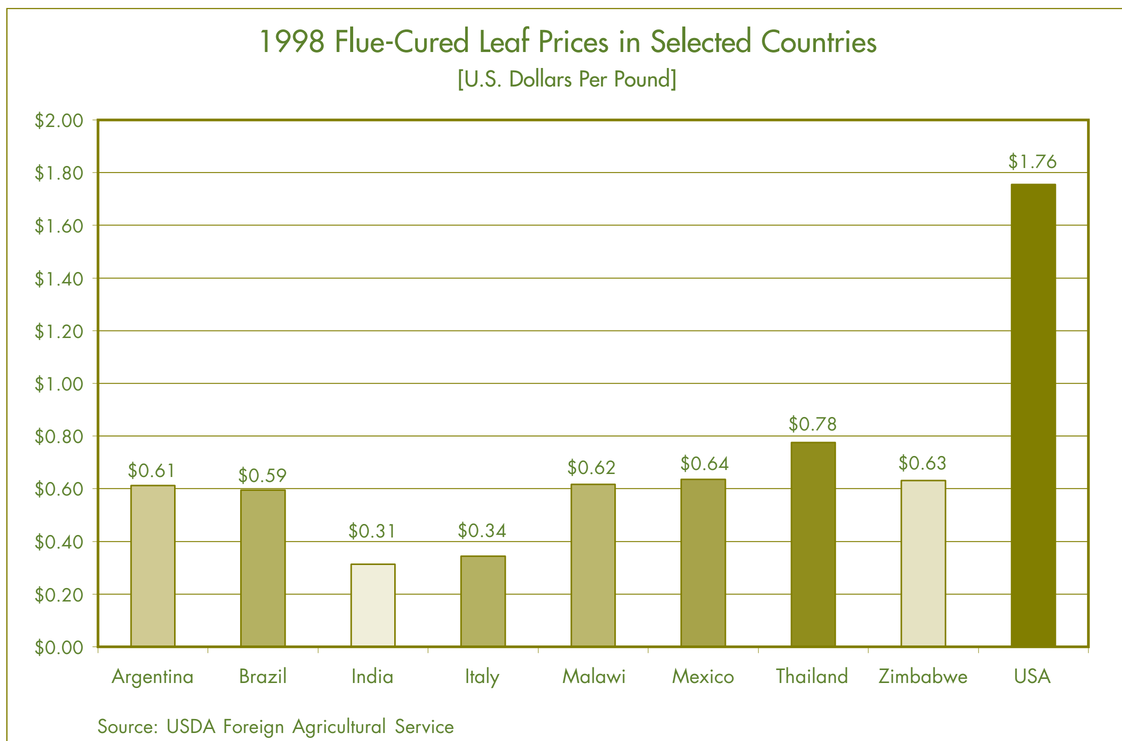
> Very few people know who the buyer of American leaf exports really is. According to the United States Department of Agriculture statistics, the biggest customer seems to be Japan, and then the Netherlands. But in fact, the biggest destination is American manufacturers' foreign subsidiary companies and licensees. The next biggest destination is the growing volume of American blend cigarettes that are sold by American manufacturers' foreign competitors as they try to compete by copying the taste characteristics of American cigarette products….[T]he aggressive and successful marketing of American cigarettes has forced our foreign competitors to try to defend their markets by imitating our type of cigarettes. This means that they need to use our type of tobacco, and the best of our type comes from America.[18]

But a closer look at the facts paints a quite different picture.

Because of the greater quantity and quality of less-expensive foreign-grown tobaccos for American-blend cigarettes, the overall demand for U.S. tobacco by overseas cigarette manufacturers (which includes the U.S. companies) has diminished, despite the large increases in foreign-made American-blend cigarettes. While U.S. tobacco exports reached a high of 700 million pounds (declared weight) in 1978, only 467 million pounds were exported in 1998. In the past 13 years, U.S. exports have exceeded 500 million pounds only once. Although U.S. burley exports have more or less maintained the levels of a decade or so ago, U.S. flue-cured tobacco exports have dropped from levels exceeding 400 million pounds per year in the late 1970s to a recent average of less than 250 million pounds per year.[19]

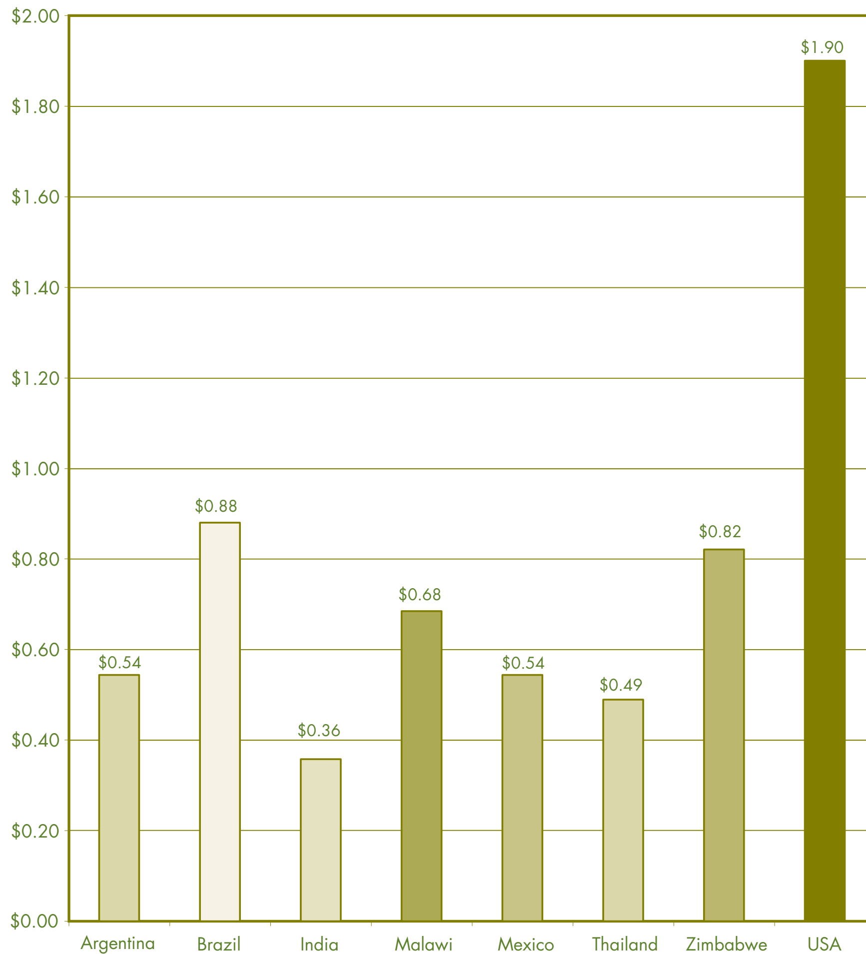
As U.S. tobacco exports have declined or stagnated, the United States' share of the world leaf-export market has fallen even faster, dropping during the past four decades from 60 percent to only about 11 percent in 1998.[20]

One reason for this decline is that the U.S. cigarette companies use relatively small amounts of U.S. tobacco in the cigarettes they manufacture overseas. The amount of U.S. leaf exports purchased by the U.S. companies is not publicly announced or reported, but if just one-third of the tobacco in foreign-made U.S. brands were from the United States, over the past several years U.S. cigarette companies would have needed considerably more U.S. tobacco for their foreign manufacturing than the entire amount of U.S. flue-cured, burley, and Maryland tobacco that was exported out of the United States.[21] In addition, internal cigarette company documents state that Philip Morris, RJR, and BAT purchased, on average, about 27 percent of all U.S. tobacco exports in the early 1990s.[22] This figure suggests that less than 10 percent of the tobacco in the U.S. companies' American-blend cigarettes manufactured overseas actu-



ally comes from the United States.[23] According to *Tobacco International,* for example, the U.S. brands from Brazilian factories do not include any U.S. tobacco at all.[24] Other foreign manufacturers of American-blend cigarettes use, on average, even less U.S. tobacco in their cigarettes than the small portion used by the U.S. cigarette companies.[25]

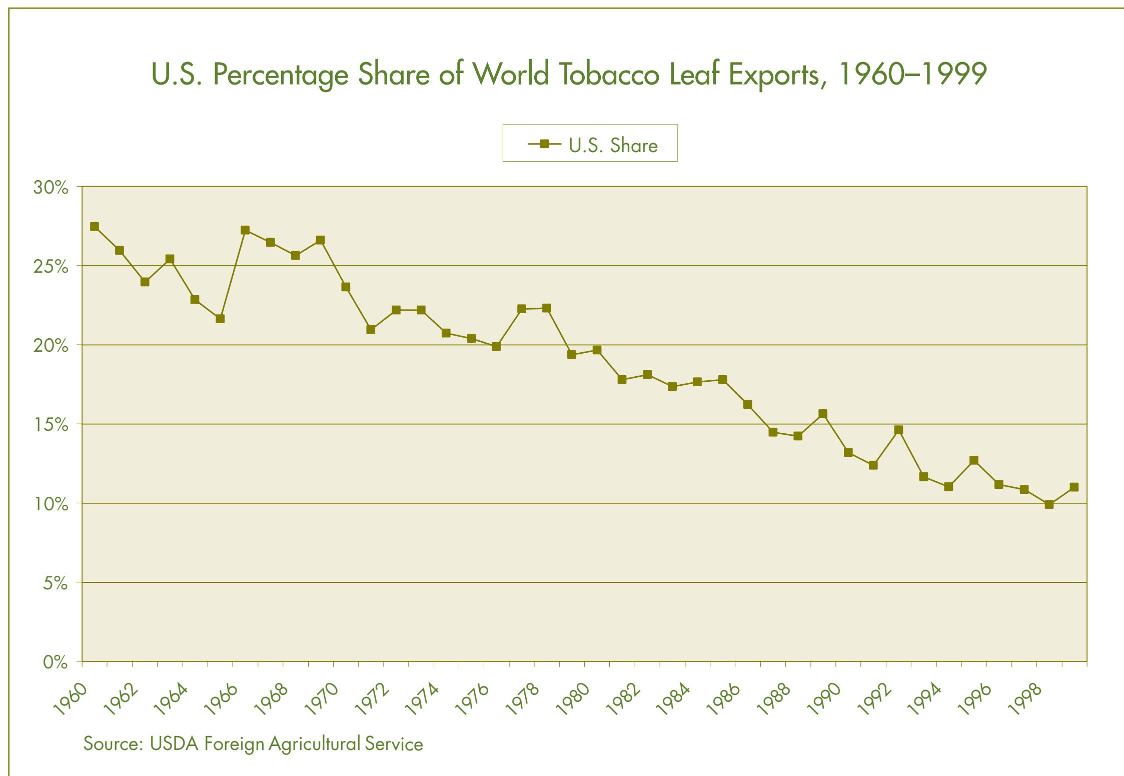
Because of the increasing use of less-expensive foreign-grown substitutes for U.S. tobacco leaf, Farrell Delman, the president of the Tobacco Merchants Association, says that U.S. growers can expect tobacco exports to continue to decline, actually falling below 1924 levels by the year 2000: "We will hit the low point in our recorded history.... It's a pretty sorry reality for the Gucci of world leaf quality."[26] If current trends continue, it is likely that all of the foreign cigarette factories—whether owned by U.S. companies or not—will use even smaller amounts of U.S. tobacco. Price cuts would, of course, make U.S. tobacco more competitive, but they would make it even harder for some U.S. tobacco growers to make ends meet and force more of the smaller farms out of business while increasing the cigarette companies' profits and revenues.[27]



The recent work of Tobacco Associates, an organization created by U.S. flue-cured tobacco growers to promote U.S. exports, shows that it will be difficult to increase or maintain the U.S. share of the global tobacco market. Despite a number of country-specific successes since Tobacco Associates stepped up its efforts in the late 1980s, the U.S. share of global tobacco exports continued to decline.[28] More specifically, Tobacco Associates has worked successfully with cigarette companies in Vietnam and Turkey to develop new American-blend cigarettes there that use U.S. and local tobaccos. But these same countries have simultaneously been developing local tobacco-growing capacity to reduce their reliance on U.S. tobacco imports and even increase their own leaf exports.[29] Moreover, while Tobacco Associates may have successfully made the Turkish tobacco monopoly, Tekel, a new customer, Tekel recently demanded and received a 25 percent price discount on a purchase of 10 million pounds of U.S. leaf stockpiled through the U.S. tobacco support program by threatening to buy all of its flue-cured tobacco overseas instead.[30]

Increased Foreign Imports

Reduced demand for U.S. tobacco has not been limited to foreign cigarette manufacturing. In 1995, the president of Philip Morris U.S.A. told a gathering of U.S. tobacco growers that "when you come right down to it, there's only one thing that makes a premium brand taste like a premium brand—the finest U.S. tobacco with which it is made."[31] But Philip Morris and the other U.S. cigarette companies have shown that they do not think that it takes very much U.S. tobacco to do the trick. Rather than rely on real U.S. tobacco leaf for their "Made in the USA" cigarettes, the U.S. companies have substantially increased their imports of foreign-grown tobacco.[32] Since the 1960s, the companies have gone from using about 90 percent



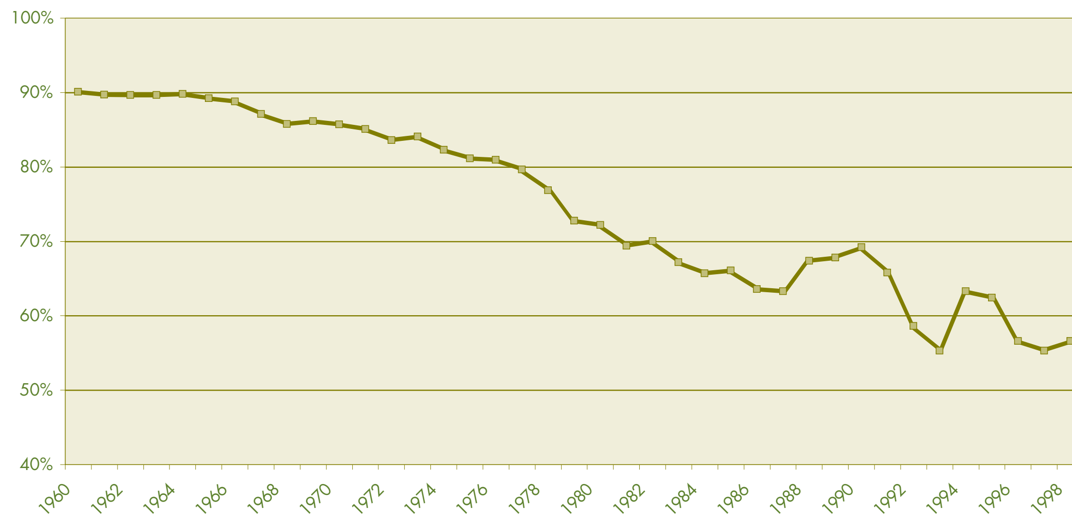
U.S.-grown tobacco in the cigarettes they make in the United States to using less than 60 percent.[33] To reassure U.S. growers, in February 1987 Philip Morris—which buys more tobacco for U.S. manufacturing than any other cigarette company—said that it would discontinue purchasing foreign flue-cured or burley tobacco in quantity for domestically sold cigarettes.[34] But the amount of U.S. burley and flue-cured leaf in each American-made cigarette has dropped by more than 20 percent since then.[35]

If the cigarette companies had used as much U.S. leaf in each of their American-made cigarettes in the past few years as they did 20 years earlier, the amount of U.S. tobacco used in U.S. cigarette manufacturing would be more than 310 million pounds larger, or approximately 45 percent higher than actual levels.[36]

Because of their switch to more foreign-grown flue-cured and burley tobaccos, the U.S. cigarette companies currently manufacture more cigarettes per year in the United States than they did in the early 1970s but use more than one-third *less* U.S. tobacco leaf in the process.[37,*]

In 1993, concerns over the amount of foreign tobacco being used in U.S. cigarettes prompted the U.S. Congress to pass the Domestic Marketing Assessment for tobacco, which limited the foreign leaf content of U.S.-made cigarettes sold in the United States to 25 percent, starting on January 1, 1994. Although this so-called 75/25 rule did not apply to exported U.S. cigarettes, in

* No good data exist on how much foreign versus U.S. tobacco each of the major U.S. cigarette companies currently use. But in a January 14, 1999, letter, Philip Morris claims that "[e]xcluding a small amount of Oriental tobacco, our domestic brands contain 90% or more of American grown tobacco." Given the data on the total amount of foreign tobacco used in all American-made cigarettes and Philip Morris's share of domestic sales and exports, the accuracy of this Philip Morris statement is highly suspect. [Letter from Steven Parrish, Senior Vice President for Corporate Affairs, Philip Morris, to the Honorable J. Phil Carlton.]

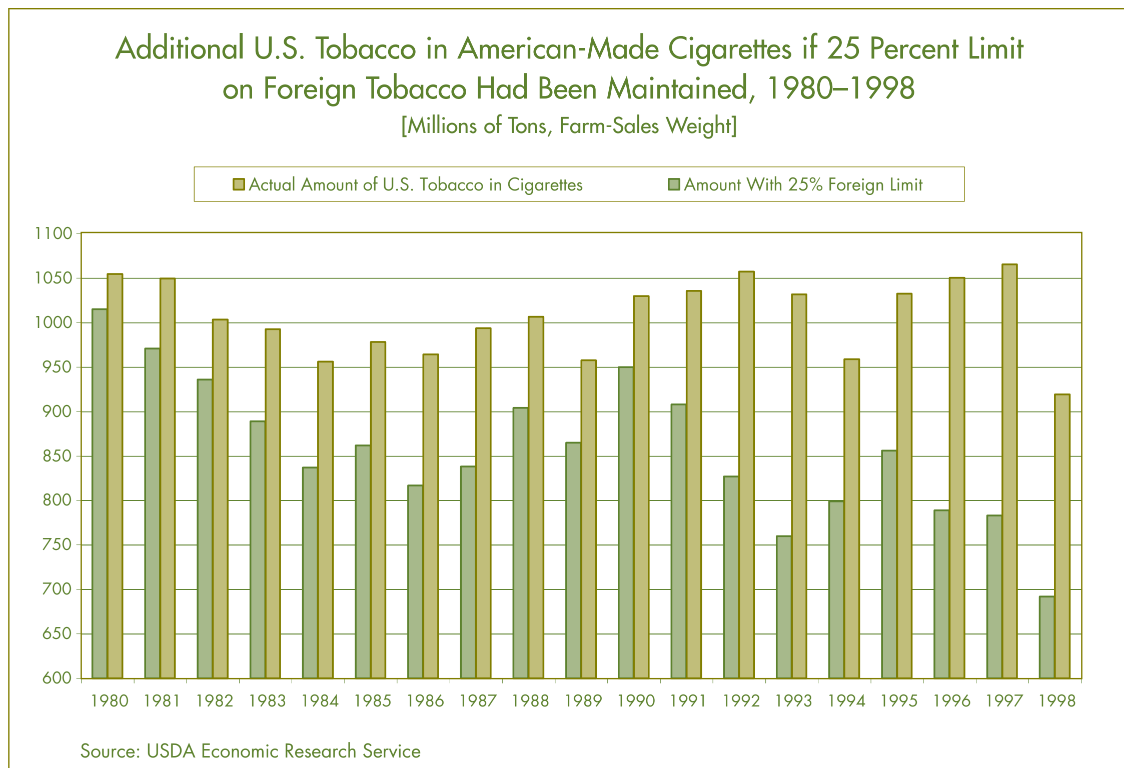


its first year tobacco imports dropped by more than 200 million pounds (declared weight), or 26 percent.[38] As stated in an SEC filing of the U.S. leaf dealer Standard Commercial, the 75/25 rule "had the effect…of drastically decreasing demand for imports of foreign tobacco for use in the domestic production of cigarettes." [39] At the same time, the 72/25 rule prompted Brown & Williamson to develop a system "to ensure B&W meets the law, but maximizes the potential of offshore tobacco."[40]

In September 1995 the 75/25 rule was eliminated, retroactive to January 1, 1995, because of concerns that it violated international trade agreements. Although the U.S. cigarette companies remained free to voluntarily follow the 75/25 rule, in the year after its repeal the companies increased their foreign imports by 280 million pounds, or more than 60 percent.[41] If the U.S. companies limited the foreign leaf in all their "Made in the USA" cigarettes to a maximum of 25 percent from the start, the total demand for U.S. cigarette tobacco over the past three years would have been more than 250 million pounds (farm-sales weight) larger each year, with the demand for U.S. flue-cured and burley tobaccos more than 33 percent higher than actual levels.[42]

As the *Washington Post* pointed out, "Use of foreign-grown tobacco [in cigarettes made in the United States] has been steadily rising for years, even as overall domestic use has leveled off. This trend has punctured the profits of [U.S.] tobacco growers."[43]

With the quality of foreign leaf increasing, the technical obstacles to using even less U.S. leaf in American-made cigarettes are disappearing. Moreover, if Philip Morris is successful in its recent efforts to get U.S. growers to segregate their tobacco into different quality grades, all of the cigarette manufacturers might be able to obtain the distinctive U.S. tobacco flavor they want by replacing the amounts of U.S. tobacco leaf they currently use in their cigarettes with substantially small-



er amounts of higher-quality U.S. leaf—while using additional amounts of foreign tobacco to make up the difference.[44]

The only legal obstacle to the U.S. companies using even more foreign tobacco in their U.S. manufacturing is the tariff-rate quota (TRQ) limits placed on the amounts of tobacco leaf that can be imported into the United States from foreign tobacco-producing countries duty-free in a given year, with a 350 percent ad valorem duty added to any imports over the quota amounts.[45] But the TRQ limits have been set so high that they have not affected tobacco imports. In the 1998/1999 TRQ year, foreign tobacco imports used up less than half of the total TRQ amount.[46] Even if the higher duty fees were ever triggered by tobacco imports from any country, a TRQ "duty-drawback" provision provides that any imported foreign tobacco that is subsequently re-exported either as leaf or in cigarettes sent overseas (roughly 30 percent of all imported cigarette tobacco in recent years) does not count toward the TRQ limit. In other words, the U.S. cigarette companies could double their use of imported foreign tobacco and reduce the amount of U.S. leaf in their U.S.-made cigarettes to 10 percent or less, without facing any new import restrictions, tariffs, or fees.

Philip Morris officials and documents claim that the U.S. cigarette companies have been generating new U.S. tobacco leaf exports through their exported cigarettes, overseas manufacturing, and promotion of American-blend cigarettes worldwide.[47] But these trends have not offset the lost U.S. tobacco sales caused by the companies' increased use of foreign leaf in their U.S. manufacturing. During the past decade, the U.S. companies have consistently imported more foreign tobacco for the cigarettes they make in the United States than the total amount of U.S. cigarette tobacco exported for overseas production.[48] Despite increasing sales of U.S. brand cigarettes sold overseas, since 1996 U.S. cigarette exports have declined by about 30 percent, reducing the amount of U.S. tobacco leaf used in U.S. cigarette manufacturing each year by at least 70 million pounds (farm-sales weight).[49]

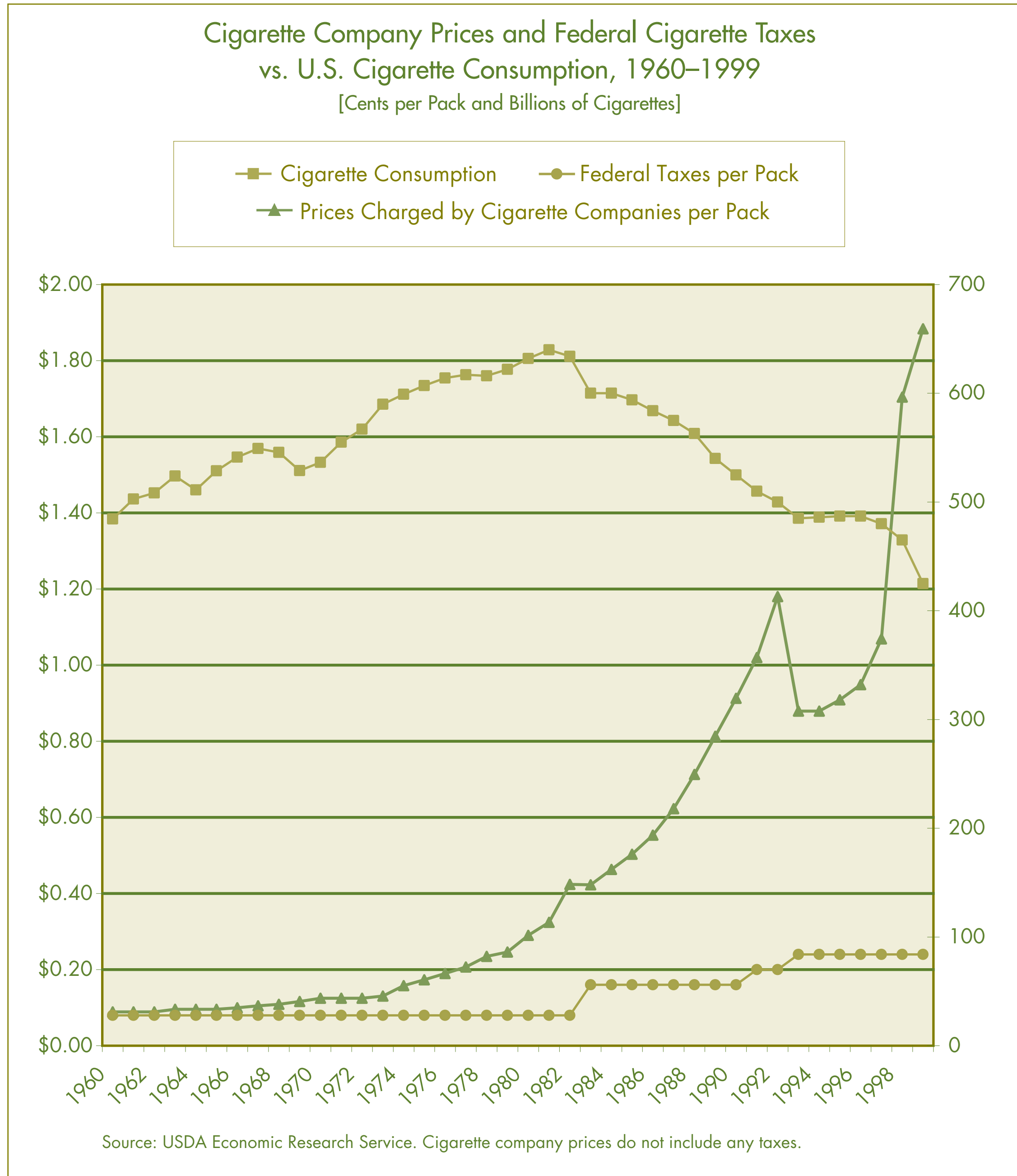
Reduced U.S. Cigarette Consumption

Instead of acknowledging their role in the reduced demand for U.S. tobacco leaf (for U.S. cigarette manufacturing), the cigarette companies often blame the ongoing smoking declines in the United States and related antismoking efforts by public health groups and the federal and state governments.[50] However, cigarette consumption in the United States has declined, on average, by only about 1.5 percent per year from 1980 to 1998 and dropped by only 4 percent from 1993 to 1998. Moreover, U.S. smokers consume only about 40 percent of all U.S. cigarette tobacco, with the rest being consumed overseas in either foreign-made cigarettes or American-made exports. Accordingly, the U.S. cigarette consumption declines of 1.5 percent per year have caused an annual reduction in the worldwide demand for U.S. cigarette tobacco of roughly 0.6 percent.[51]

In contrast, the U.S. cigarette companies' increased use of foreign tobacco in the cigarettes they manufacture and the declining global market share for U.S. tobacco leaf have caused much more severe reductions in demand. For example, if U.S. growers still controlled the same percentage of global tobacco exports as they did in 1980—before the U.S. cigarette companies and leaf dealers began to aggressively develop foreign tobacco growing—the overall annual demand for U.S. tobacco would be about 480 million tons (farm-sales weight) or more than 30 percent larger than the average demand in recent years.[52] Had U.S. tobacco growers just been

able to maintain the same average level of annual exports they shipped in the early 1980s, in the past three years the annual demand for U.S. tobacco would have been more than 110 million pounds or 7 percent higher.[53] And if the U.S. cigarette companies were still using the same amount of U.S. tobacco in each of their U.S.-made cigarettes as they did in 1980, the total yearly demand for U.S. tobacco would be more than 310 million tons larger, or over 20 percent higher than actual recent levels.[54]

Similarly, consumption declines cannot account for the recent record-setting declines in U.S. cigarette company purchases of U.S. leaf used for cigarettes. Despite announcing in 1997 that they expected to buy more tobacco from U.S. growers over the next three years,



Source: USDA Economic Research Service. Cigarette company prices do not include any taxes.

from 1997 through 1999 the U.S. cigarette companies have reduced their purchases of U.S. tobacco leaf for U.S. cigarette manufacturing by about 35 percent—which has produced unprecedented cuts in the basic quota of tobacco the U.S. tobacco price support program allows U.S. growers to produce.[55] Nor can consumption declines explain the additional large reductions tobacco industry analysts expect in the year 2000.[56] [For more information on how the U.S. tobacco price support program works, see Appendix III.]

While the companies have again pointed to both past and predicted U.S. smoking declines to justify their reduced purchases, they rarely explain that the primary cause of the declines in U.S. cigarette consumption from 1997 to at least 2001 has been and will be the companies' own cigarette price increases.[57] Cigarette price increases are one of the most powerful ways to reduce smoking; the companies' November 1998 price hike of 45 cents per pack was their largest single cigarette price increase ever in the United States, and their late August 1999 price increase of 18 cents per pack was the second largest.[58] The cigarette companies foster the impression that these price hikes and others were necessary so that they can make the various payments required each year by the state tobacco lawsuit settlements.[59] But the revenues from the price increases will be much larger than necessary to finance all of the cigarette companies' settlement-related costs, bringing the companies about $5 billion more per year than their settlement costs warrant.[60]

In any case, from 1997 to 1998, U.S. cigarette consumption declined by only about 3 percent, and the cigarette companies' price hikes in 1998 and 1999 (which currently total 81.5 cents per pack at the factory level) are expected to reduce U.S. cigarette consumption in 1999 by another 6 to 10 percent in 1999, followed by a return to historical levels of declines.[61] The U.S. Department of Agriculture Economic Research Service estimates that the 1998 cigarette price increases, combined with the recent increases in some states' cigarette taxes, will reduce U.S. consumption by only about 8 percent beyond preexisting trends over the next 10 years.[62] Even Philip Morris's Chairman and Chief Executive Officer Geoffrey C. Bible acknowledged to the company's shareholders in April 1999 that "we've seen the biggest part of the decline," and future U.S. consumption declines should revert to the 1 to 1.5 percent per year pace of the past two decades or "maybe a little higher."[63,*]

In a subsequent communication to U.S. growers, however, Philip Morris took a different position in order to try to justify the cigarette companies' recent reduced purchases of U.S. leaf. Contradicting Bible's statement to the company's shareholders, the communication stated that while U.S. cigarette consumption has been declining by roughly 1 to 2 percent per year over the past 20 years, Philip Morris "would not be surprised to find the market shrinking at an accelerated pace in the years to come."[64]

When evaluating these consumption decline arguments, it is important to recall that actual U.S. cigarette consumption declines will not produce parallel reductions to the domestic demand for U.S. leaf because

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* Normally, an 81.5-cent price hike would have had a much sharper impact on U.S. cigarette consumption, but the companies' 1998–1999 price increases were spread out over 14 months. In addition, the cigarette companies have taken aggressive steps to dampen the antismoking impact of their price hikes by using temporary retail-level promotions, discounts, and coupons both to disguise the price hikes and to phase them in. [See, e.g., Credit Suisse First Boston Corporation, "U.S. Tobacco Industry Promotional Spending—A Prisoners' Dilemma," April 26, 1999.] As one Wall Street tobacco analyst characterized it, the cigarette companies are taking these actions to "wean customers to higher prices gradually." [Skip Wollenberg, Associated Press, "Tobacco Promotions Curb Price Shock," September 23, 1998.]

almost a third of all the U.S. tobacco the U.S. cigarette companies have purchased to supply their U.S. factories has been used to produce American-made cigarettes for export, and the demand for exports is unaffected by U.S. smoking declines.[65] Accordingly, even a decline in U.S. smoking of 10 to 14 percent from 1997 to 1999 could account for only a 7 to 10 percent reduction in the companies' total domestic demand for U.S. leaf. But such a drop could account, at most, for only one-fourth of the unprecedented reductions in the cigarette companies' domestic purchases from 1997 to 1999—and would provide no justification for any additional purchase declines in the year 2000.

Other Factors Affecting the Demand for U.S. Tobacco

University of Kentucky tobacco economist William Snell suggests that the cigarette companies' recent reduced purchases of U.S. leaf might come from a new cigarette company strategy: they reduce their own tobacco inventories and let tobacco stocks pile up in the cooperatives that buy and store all U.S. leaf produced under the U.S. tobacco price-support program each year that is not purchased by manufacturers or leaf dealers.[66] This way, the cigarette companies save money by reducing their current leaf purchases and by not having to keep up their own inventories but still have adequate additional stocks available, as needed, from the cooperatives. Because excess inventory held by the cooperatives reduces the amount of tobacco the U.S. tobacco support program allows U.S. growers to produce, the companies have in the past been able to buy leaf held by the cooperatives at a substantial discount.[67] Just recently, Philip Morris has again offered to buy inventory stocks at a discount of 45 to 50 percent, but the grower cooperatives have not been willing to sell at such low prices.[68] [For more information on how the U.S. tobacco pricesupport program works, see Appendix III.]

This strategy puts U.S. growers in a difficult situation. If they sell excess tobacco-program inventories to the cigarette companies at discount prices, the companies will need to buy less tobacco from the regular U.S. markets (and will have to pay additional tobacco-program support fees to cover the discounts). But if they do not sell off the built-up tobacco-program inventory or pool stocks, the program's formula for calculating annual tobacco quotas will reduce the amount growers can produce and sell.[69] As U.S. Representative Scotty Baesler (D-KY) said of a similar situation a few years ago, "My concern is that if the companies buy the pool stocks, then all they'll do is cut their purchase intentions. What good does it do to have them buy this pool tobacco if all they do is buy less in the future? The grower is once again going to be the one to suffer in this."[70]

Although less conspicuous, several other factors—besides the cigarette companies' switch to foreign manufacturing and foreign leaf—could also be reducing the overall yearly demand for U.S. cigarette tobacco:

- The growing worldwide trend favoring lower-tar and lower-nicotine American-blend cigarettes enables cigarette manufacturers to use more lower-quality leaf or reconstituted tobacco in place of high-quality U.S. leaf.[71] As Robert Jones, president of Universal Leaf Tabacos, the Brazilian subsidiary of Universal Corporation, puts it, "As smokers around the world turn to low-nicotine brands, medium-grade tobacco can be easily used, whereas the richest American tobacco would be wasted."[72] Low-tar cigarettes also tend to use less tobacco overall than regular cigarettes.[73]

- In 1997, *Tobacco Reporter* noted that a large percentage of blended cigarettes were already using sheet tobacco—made from reconstituted scraps, stems, dust, and rejected leaves and stalks—as a cheaper alternative to tobacco leaf, and that the demand for reconstituted tobacco could increase by 4 to 6 percent per year through the year 2005.[74] Following this trend, cigarette manufacturers can increase the amount of leaf tobacco they are actually able to use from each ton they purchase, thereby reducing their overall demand for tobacco leaf. Accordingly, RJR's and others' direct sales of reconstituted tobacco to manufacturers constitute a growing competitor to U.S. leaf sales.[75]
- Another technological challenge to U.S. tobacco growers comes from the recent advances in tobacco expansion processes, including newly patented methods and technologies controlled by the major U.S. cigarette companies.[76] With new high-order processes, the volume of tobacco leaf can be doubled before it is put into any cigarettes, thereby reducing the overall amounts used. Other technological innovations, including advances in tobacco flavorings and other additives, have also enabled U.S. cigarette companies to use larger proportions of lower-quality tobacco while still maintaining overall quality for smokers.[77] As Kirk Wayne, president of Tobacco Associates, puts it, "They puff it, fluff it, and flavor it" to cut the costs of buying more expensive tobaccos.[78]

Estimated Demand for U.S. Tobacco in the Near Future

The U.S. cigarette companies' reduced purchases of flue-cured and burley tobacco in 1998 and 1999 have already sharply reduced U.S. growers' tobacco sales and income. Tobacco analysts expect further reductions in the companies' purchase intentions in the year 2000, which would also reduce overall quota levels (the amount U.S. growers are allowed to produce under the industry-supported tobacco price-support program). In a recent communication to U.S. growers, Philip Morris stated that "there's not much room for short-term improvement, with the possibility of further quota cuts for 2000 looming on the horizon."[79]

Looking even further ahead, industry analysts predict only a partial recovery, at best, in subsequent years. Most notably, tobacco economist William Snell estimates that the cigarette companies' purchase intentions for U.S. burley tobacco would have to increase by more than one-third to avoid another cut in the overall burley quota. Instead, he expects a 20 percent quota drop for 2000 and sees long-term total U.S. burley demand fluctuating around an average of roughly 475 to 500 million pounds per year, about 100 million pounds lower than the average total demand in recent years.[80] For flue-cured tobacco, North Carolina State University tobacco economist Blake Brown believes further quota reductions are possible. More significantly, he expects that *even if U.S. leaf and cigarette exports recover,* total long-term demand for U.S. flue-cured will still fluctuate around 750 million pounds per year, down about 100 million pounds from the average over the past 10 years.[81]

> "We're kind of shocked at the [cigarette companies'] purchase intentions. We're really at a loss of words for why purchase intentions should be so low for 1999."
>
> ***—Arnold Hamm, Ass't General Manager, North Carolina Flue-Cured Cooperative***

The continuing efforts of Philip Morris and BAT to increase their foreign manufacturing

capacity and the purchase by Japan Tobacco of the right to sell RJR brands overseas make any recovery of U.S. cigarette exports highly unlikely. With U.S. cigarette company and leaf dealer support, foreign production of American-style cigarette tobaccos also continues to expand and improve, making it increasingly harder for U.S. growers to maintain their export market share, much less increase it.

I think the farmers have to realize that
we are just a cog in a larger business.[1]

—Don Anderson, Virginia Tobacco Grower

The notion that the [U.S. cigarette] companies don't care about [U.S.] growers is simply wrong. They just get down in the dumps when their livelihood is in peril.[2]

—Phil Carlton, Attorney and Spokesperson for U.S. Cigarette Companies

III. As Cigarette Company Profits Rise, Tobacco Grower Losses Mount

By moving overseas and increasing their use of foreign tobacco in the cigarettes they still manufacture in the United States, U.S. cigarette companies have enjoyed enormous increases in their revenues and profits—despite the declines in U.S. smoking rates, the lawsuits against the companies, and the recent settlements with the state attorneys general. At the same time, the U.S. tobacco growers are trying to adapt to the U.S. cigarette companies' reduced purchases of U.S. tobacco leaf and are struggling both with higher production costs and with stagnant leaf prices that have not kept up with inflation. U.S. workers in the tobacco industry are also losing their jobs, and various businesses that have supplied the U.S. tobacco companies with supplies or services have had to downsize as well.

Prices, Profits, and Revenues

Since 1985, Philip Morris's total annual tobacco revenues have more than quadrupled, growing from $10.6 billion to more than $42 billion. During the same period, its tobacco profits have increased from about $2.5 billion to more than $6.5 billion in 1998, despite a one-time charge against profits of $3.4 billion to cover costs associated with the state tobacco settlements. The other U.S. cigarette companies have also experienced similar revenue and profit increases despite their smaller domestic and international market shares.[3,*]

The state settlement charges against the U.S. cigarette companies will not change the picture. Philip Morris and the other U.S. cigarette companies have already raised their U.S. cigarette prices not only to cover all their settlement costs but to bring in billions of extra income.[4] The companies' increased income per pack sold will exceed any revenue losses from selling fewer packs, especially since the companies have reduced the impact of their price hikes on sales through aggressive temporary discounting and other promotions.[5] While the U.S. cigarette companies' sales slumped in the first quarter of 1999 because of the 45-cents-per-pack price hike

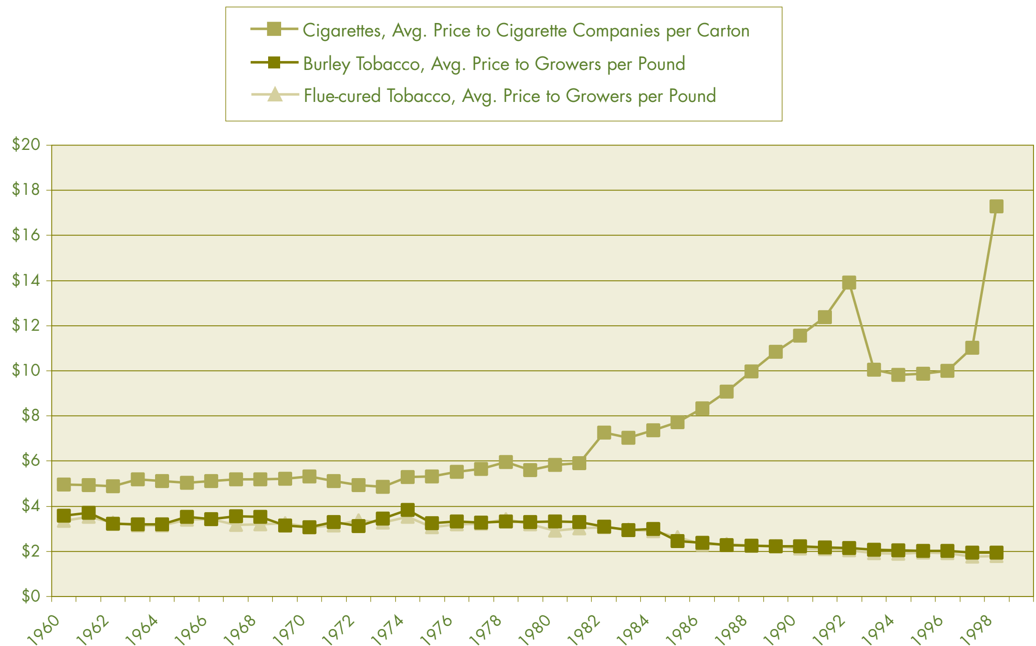
* The leaf dealers have also been prospering. Dimon, for example, saw its overall profits increase from $14.4 million in 1994 to $155 million in 1998. While the leaf dealer's U.S. tobacco profits doubled over this period, its foreign tobacco profits increased by more than 600 percent. [Dimon SEC Filings.]

in November 1998, Philip Morris's U.S. tobacco revenues for the quarter still increased by $1.1 billion.[6]

According to Jay Nelson, a tobacco analyst at Brown Brothers Harriman & Co, "Cigarette companies have an enviable weapon at their disposal if future legislation or negative public sentiment decreases consumption.... [T]hey can always generate cash quickly by raising prices.... With 24 billion packs sold annually, a five-cent increase is a tidy $1.2 billion."[7]

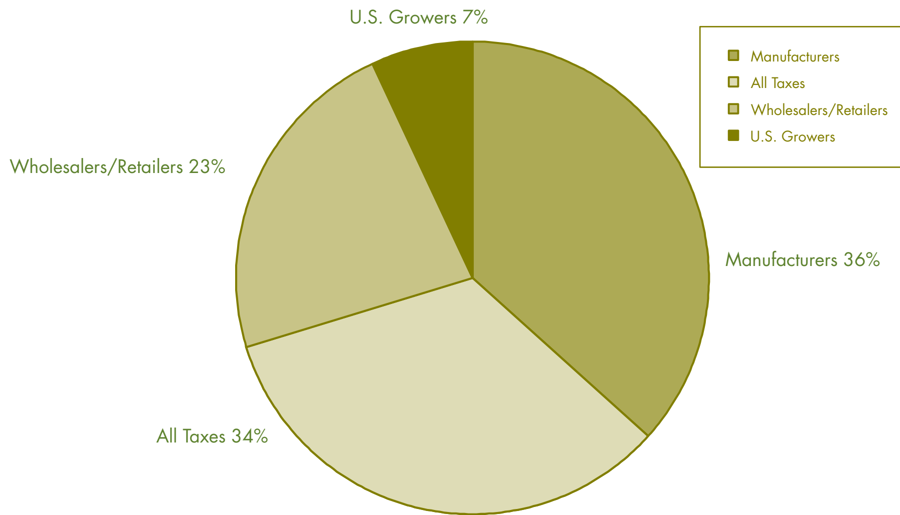
Nonetheless, the U.S. cigarette companies have persistently complained that they are in dire economic straits.[8] As one industry analyst explained in 1998, "They definitely don't want to let on that things are going well. If they do, most likely they'll be slapped with a tougher settlement."[9] The companies have even tried to justify their increased reliance on foreign manufacturing and foreign tobacco leaf as necessary cost cutting to survive in a more competitive global market.[10] As David Milby, Philip Morris's vice president for leaf, said in 1993, "Our greatest challenge in the leaf department of Philip Morris is to contain costs and maintain quality to keep us competitive in the marketplace. The result of this challenge is a growing demand for less expensive tobaccos [that] is causing U.S. cigarette manufacturers to increasingly evaluate flue-cured and burley tobaccos grown off-shore."[11]

Although the cigarette companies frequently complain that U.S. leaf prices are too high, the companies are currently paying U.S. growers less per pound of tobacco, after adjusting for inflation, than they paid them 10 or even 20 years ago—despite major increases in growers' costs and massive



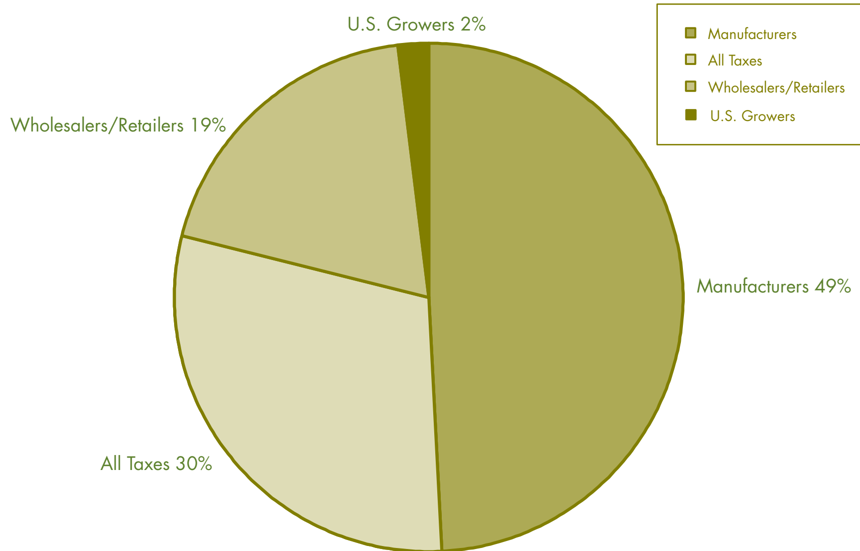
Source: USDA Economic Research Service. Prices do not include any taxes.

Where the Tobacco Dollars Went—1980



Source: V. Grise, "The Changing Tobacco User's Dollar," USDA Economic Research Service, *Tobacco Situation & Outlook,* June 1992.

Where the Tobacco Dollars Went—1998



Source: Tom Capehart, USDA Economic Research Service

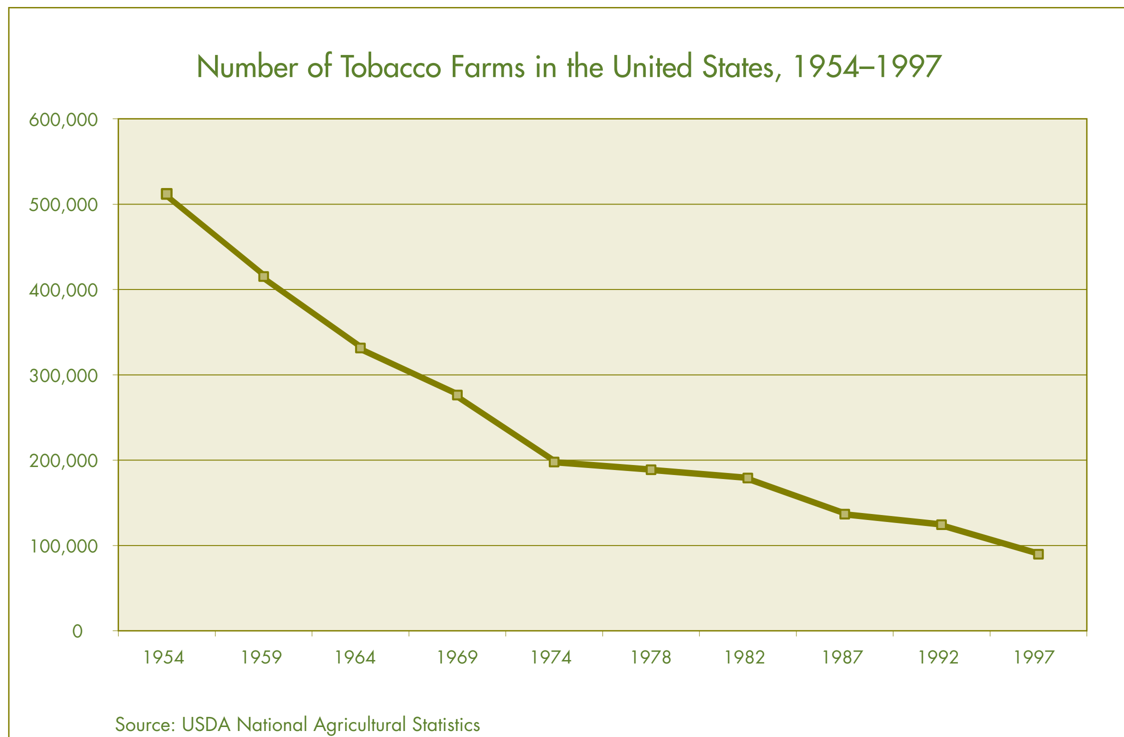
Pie charts show where each dollar spent on tobacco products in the United States went in 1980 and 1998.

1998 pie chart does not reflect the cigarette companies' 45 cents-per-pack increase in November 1998.

increases to the cigarette companies' own prices.[12] Between 1980 and 1998, general inflation went up by over 90 percent and the inflation-adjusted cost of growing tobacco increased nearly 200 percent—but the average price per pound for U.S. flue-cured tobacco leaf rose just 19 percent and burley prices rose only 14 percent. At the same time, the wholesale price of cigarettes charged by the cigarette companies, excluding taxes, increased by 269 percent.[13]

Speaking in 1994, before the latest round of cigarette company price increases, U.S. Representative Charlie Rose (D-NC) asked, "Through wholesale price hikes, manufacturers have reaped an additional $69 billion in profit, while growers have suffered an accumulated loss of about $500 million and have seen steady declines in their quota…. A fair question is, who has reaped the profits?"[14] As Rep. Rose and many others point out, the tobacco growers' share of each dollar spent in the United States on a pack of cigarettes dropped from seven cents in 1980 to about three cents in the early 1990s, while the cigarette companies' share increased from 37 to 50 cents.[15] Since then, the U.S. tobacco growers' share has shrunk to less than two cents per pack.[16]

In 1997 (the most recent year for which USDA Census of Agriculture data are available), the *average* tobacco farm used fewer than 10 acres to grow tobacco and brought in a bit less than $44,000 in gross revenues from tobacco sales. But the majority of tobacco growers have gross sales of less than $20,000 per year from tobacco. In Kentucky, tobacco growers sell, on average, less than $19,000 worth of tobacco each year, and Tennessee growers sell less than $14,000. Because of these low tobacco revenues, most U.S. growers must also work at jobs off the farm to supplement their income.[17] In contrast, Philip Morris Chairman and CEO Geoffrey Bible received a raise and bonus that brought his 1998 compensation to $24 million in salary, bonuses, and stock options, while the chairman and CEO of RJR ended up with about $12 million.[18]



Any historical concern the cigarette companies may have had for the well-being of their U.S. workers and tobacco growers has, to say the least, faded. As Universal's Brazil representative puts it, "Ten to 20 years ago, the business was built much more on personal relationships." Today, he says, there's a "pure business view."[19]

Disappearance of the Family Farm

While the U.S. cigarette companies have prospered, declining tobacco leaf prices, reduced demand, and increased production costs have been threatening the survival of the small family farms that still make up the vast majority of U.S. tobacco farms. In the 1950s, there were more than half a million tobacco farms in the United States. Now, there are fewer than 90,000—and more than half of all the small tobacco farms operating in 1982 have since disappeared.[20]

While the number of smaller tobacco farms has been shrinking, larger, more mechanized farms have been absorbing their production quotas and taking their place. Since 1982, for example, the number of tobacco farms larger than 50 acres has more than doubled.[21]

Decline in Number of Tobacco Farms of Less Than 50 Acres, 1992–1997

	1992	1997	Percent Change (%)
Kentucky	20,455	13,835	–32
Tennessee	10,538	6,261	–41
North Carolina	5,634	3,212	–43
Virginia	3,135	1,920	–39
South Carolina	345	168	–51
Georgia	129	69	–47
USA Totals	121,679	86,137	–29

Source: USDA 1997 Census of Agriculture

As these trends continue, those growers with the smallest farms and lowest incomes are the most vulnerable. According to the National Commission on Small Farms, "Tobacco income is particularly important to limited resource farmers, African-American farmers, and the Appalachian mountain regions of the South…. [T]obacco accounts for half or more of total farm sales on nearly one-third of African-American-operated farms in the east coast of the States from North Carolina to Maine."[22]

Looking ahead to the expected further reductions to tobacco-growing quotas for the year 2000, James Starkey, a vice president at Universal Corporation, the world's largest leaf dealer, notes that "It's going to be devastating. A lot of growers, a lot of good growers, are going to be forced out of business."[23] As the *Richmond Times-Dispatch* observes, "There may not be much more time for smaller growers."[24]

Tobacco Manufacturing Job Losses

The workers in the cigarette companies' U.S. factories have also felt the effects of the industry's shift overseas. As they increase their manufacturing capacity abroad, the companies have been laying off thousands of their U.S. employees as part of their "restructuring" efforts. From 1982 to 1996 (the most recent year for which U.S. Census manufacturing data are available), the number of people directly employed in tobacco manufacturing in the United States dropped from 58,000 to just over 31,000—a decline of more than 45 percent.[25] Since 1996, the job losses have continued, if not accelerated.

In December 1997, RJR announced it would shut down its Brook Cove, North Carolina, leaf-processing plant and do other "restructuring," which would eliminate 390 jobs.[26]

In early 1998, Philip Morris announced the closing of its Stockton Street factory in

Richmond, Virginia, which employed 800 workers, and then said that it would be cutting its U.S. workforce by another 2,000 (or 12 percent), primarily through early retirement programs.[27] In July 1998, Philip Morris announced another 280 job cuts in Richmond, Virginia, and Louisville, Kentucky, with early retirement incentives offered to 300 more workers.[28]

In December 1998, RJR announced it would cut 1,300 jobs at its Winston-Salem plant.[29]

Earlier in 1998, Geoffrey Bible denied rumors that Philip Morris might close cigarette plants in Virginia, North Carolina, and Kentucky and move overseas, saying: "We prefer to manufacture cigarettes for the domestic market here in the U.S."[30] But less than a year later, after more layoffs and early retirements, Philip Morris announced that it would stop making cigarettes in Kentucky, closing down its Louisville plant and laying off the remaining 1,400 workers.[31] As might be expected, many tobacco workers feel betrayed. As tobacco worker union representative Ron Harsh pointed out, "We've written the letters, we've made the phone calls and been on the street in support of the tobacco industry."[32] In April 1999, Bible again promised that no U.S. tobacco manufacturing jobs at Philip Morris will be exported overseas.[33]

In August 1999, Brown & Williamson announced it will cut 15 jobs at its Lancaster, Pennsylvania, plant and that the company expects to close the facility by the end of 2000.[34]

As the cigarette companies shut down U.S. manufacturing facilities and cut back their U.S. orders, various cigarette company suppliers are also beginning to slash jobs. In March 1999, for example, the leaf dealer company Dimon announced plans to shut down its Kinston, North Carolina, tobacco processing plant and reduce staffing at its Farmville, North Carolina, facility—thereby laying off a quarter of its workforce, some 200 full-time employees and 1,000 seasonal workers. As company CEO Claude B. Owen Jr. noted, "Unfortunately, with the uncertainty that continues to swirl throughout all sectors of the U.S. tobacco industry, we don't expect the orders or processing business to return in the near future."[35] The decline in U.S. cigarette company manufacturing has also led cigarette paper manufacturer P.H. Glatfelter to lay off 215 U.S. workers.[36]

While the cigarette companies have eliminated tens of thousands of jobs for U.S. workers over the past two decades, their enormous investments in overseas cigarette manufacturing and processing have created tens of thousands of new jobs for foreign workers.[37]

[The U.S. tobacco program] protects us—that's the shield. That's the only thing that's kept us from the companies. That's the only thing that protects us from them coming down. It's not like most agricultural commodities where you have several buyers—we only have three or four. And so we have to have that protection to remain viable. Without that protection, we become an appendage of the tobacco companies, and we're completely at their mercy. And I don't think that Congress or this Administration or the American people want that to happen.[1]

—Rod Kuegel, President of the Burley Tobacco Growers Cooperative Association

The cigarette companies have made it clear that they don't care that much about the program, other than they don't like it much.[2]

—Michael Walden, Professor of Economics, North Carolina State University

IV. The U.S. Tobacco Price-Support Program: Its Future and Its Impact on Family-Run Tobacco Farms

Since the early 1930s, U.S. tobacco farming and the sale of U.S. tobacco have been regulated by the U.S. tobacco price-support program. Designed to protect U.S. growers and ensure buyers a stable supply of high-quality U.S. tobacco, the program has stabilized U.S. tobacco prices, managed the overall amount of U.S. tobacco cultivation, and blocked domestic competition by big-business newcomers. The tobacco program limits the amounts of tobacco that can be grown in the United States, restricts who can grow it, sets minimum prices for different types of U.S. tobacco, and ensures that any tobacco produced within the set limits that is not sold in the regular tobacco markets will still be purchased by tobacco cooperative associations. Since 1982, the program has been financed by fees charged to U.S. growers and their buyers. The U.S. government covers only the administrative costs.[3] [For more information on how the tobacco price-support program works, see Appendix III.]

Without the program, U.S. tobacco prices would be lower, most smaller and family-run tobacco farms (which make up the vast majority of all U.S. tobacco farms) would be forced out of business, and tobacco production in the United States would probably be dominated by large tobacco-growing agribusinesses.[4] As agricultural economist and tobacco specialist William Snell, from the University of Kentucky, testified before the U.S. House of Representatives Agriculture Committee, "unlike other farm programs of the past, the price stabilizing, production control measures of the tobacco program have certainly contributed greatly to sustaining thousands of small family farms in Kentucky and other burley tobacco-producing states."[5] More than 90 percent of U.S. burley and flue-cured quota holders have repeatedly voted to maintain the tobacco program, and support from the program among all growers (including those that only lease quotas) has been consistently high.[6]

The Cigarette Companies and the Tobacco Price-Support Program

For years, the U.S. cigarette companies have expressed support for the U.S. Tobacco price-support program, but they have been steadily decreasing their participation in it by buying foreign leaf instead. Because of the U.S. cigarette companies' foreign purchases, prices for U.S. cigarette tobacco have not kept up with inflation over the past 10 or 20 years, despite the price-support program. More recently, the program has sharply reduced its annual basic quotas (the amount of tobacco U.S. growers are allowed to produce) because of the companies' sharply reduced purchases of American-grown leaf.[7] As Philip Morris Vice President for Leaf David Milby admitted several years ago, "It is hard to maintain the integrity of the tobacco program at the same time that you're competing in the lower-priced leaf market."[8]

> "If they destroy the program, we'll be at the mercy of the cigarette companies."
>
> ***—Howard Montague, Kentucky Tobacco Grower,* Lexington Herald-Leader, *June 21, 1998***

Some growers suspect that Philip Morris and the other U.S. cigarette companies have been secretly working to undermine the program for some time. As one grower notes, "it's a strategic move not to have their fingerprints on dismantling the program."[9] Similarly, some industry analysts believe that the cigarette companies offer public statements of support and refrain from overtly attacking the tobacco program "in return for political support from farmers and other quota holders."[10] During the Senate's consideration of the McCain comprehensive tobacco legislation in 1998, for example, there was a debate over provisions introduced by Senator Richard Lugar (R-IN) that would have eliminated the tobacco price-support program over three years.[11] Although the cigarette companies did not publicly support the Lugar provisions, Senator Fritz Hollings (D-SC) repeatedly voiced his concerns, on the Senate floor, that the cigarette companies were supporting the Lugar approach behind the scenes—out of their desire to reap enormous profits from the termination of the price-support program.[12] Senator Chuck Robb (D-VA) argued that killing the tobacco support program would create not a free market but rather an oligopoly in which the four cigarette companies that currently buy 98 percent of all U.S. tobacco "would dictate the price to sellers and reap the rewards…. The only true benefactors would be large corporate farms and tobacco companies."[13] Ultimately, the Senate rejected the entire McCain bill and never reached any decision on the Lugar provisions.*

While never saying publicly that they want to end the tobacco support program, the cigarette companies have made it clear for some time that they would like to pay much lower prices for U.S. tobacco leaf—and the one way

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* Some observers believe that the cigarette companies' successful efforts to keep the U.S. Senate from passing the McCain bill in 1998, which many growers and grower organizations supported, have taught the cigarette companies that they can succeed politically without strong support from the growers. As a congressional aide, who asked not to be identified, put it in an interview for this report, "The companies decided it was easier to spend $40 million on ads than to rally grower support to defeat the McCain bill." Following similar reasoning, a study by three major tobacco industry analysts recently concluded that "the political influence of the producer community may not carry the same weight in the manufacturers' eyes in the future." [A. Blake Brown, et al., "The Changing Political Environment for Tobacco," Southern Agricultural Economics Association Annual Meeting, February 2, 1999.]

to significantly reduce U.S. leaf prices is to eliminate the tobacco price-support program or make major changes to it that would enable larger, more mechanized farms with much lower production costs to take over the production of U.S. tobacco. Philip Morris's confidential "Washington Outlook for 1994," for example, described how the company would "attempt to direct the debate [over tobacco imports] towards measures to improve the price competitiveness of U.S. leaf in the world markets in order to minimize leaf export and cigarette export losses."[14]

William Campbell, the president and CEO of Philip Morris U.S.A., told Kentucky growers in 1994 that "we need to be able to buy your tobacco at competitive prices." [15] After admitting that U.S. manufacturers were already turning to foreign producers for less-expensive leaf, Campbell further warned the growers that "if your prices are raised to the point that customers no longer feel they are getting value for their purchases, they will turn elsewhere." Also in 1994, Philip Morris Vice President for Leaf Dave Milby made the same points before the Burley Auction Warehouse Association, and then went even further, stating that the challenge for growers was to make their prices competitive enough to "keep the federal tobacco program viable."[16] In a similar 1995 speech to growers, the CEO of Philip Morris U.S.A., James J. Morgan, stated that "On the issue of price competitiveness, it is our feeling that the grower community should give more thought to taking action to improve the position of U.S. tobacco in relation to the world market.[17,*]

By their purchasing decisions, the cigarette companies put additional pressure on growers to support changes to the existing system. In fact, the companies' announced purchase intentions for 1999 (the amount of U.S. leaf they have pledged to buy under the price-support program) were so low that they forced record-breaking reductions in the production quotas for U.S. tobacco. Flue-cured growers now face the smallest quota in the history of the program, 666.2 million pounds, down 17.5 percent from 1998, and 35 percent lower than the 1997 quota, with further declines likely. Burley growers were hit by the biggest quota cut in the program's history, down 29 percent from the 1998 quota, which was already 9 percent lower than the quota in 1997, and further declines are expected.[18] Tobacco insiders believe that the 1999 quota cuts will put hundreds of growers out of business and cause enormous difficulties for tobacco-dependent businesses and communities.[19] In a letter to the cigarette companies, Virginia Governor Jim Gilmore wrote, "There are concerns that the announcement of reduced purchase intentions for the second straight year is an attempt by the industry to apply pressure to the tobacco program and end the quota system."[20,†]

At the same time, the cigarette companies have become increasingly public about their desire for fundamental tobacco program changes. In 1998, for example, Universal, one of the major U.S. leaf dealers, disclosed that

* Nowhere in these speeches do the cigarette company executives mention that despite the tobacco support program in the 10 years preceeding the speeches, the cigarette companies' cost per pound for U.S. leaf had dropped by more than 30 percent in constant dollars. [USDA Economic Research Service price data; Bureau of Labor Statistics inflation data.]

† Documents disclosed in the state tobacco lawsuits suggest that the cigarette companies have been preparing for the end of the U.S. tobacco support program for quite some time. In a September 1985 memorandum, Philip Morris carefully outlines the pros and cons of the various strategies it could pursue if the tobacco price-support program ended. ["Possible Leaf Purchasing Strategies If U.S. Tobacco Quota and Price Support Program No Longer Exists," *Philip Morris Leaf Buying Coordination Meeting Presentations,* September 26 and 27, 1985, Philip Morris Document Nos. 2000522719 et seq. at 2000522744-45.]

because "the price support system has caused U.S. grown tobacco to be more expensive than most non-U.S. tobacco…tobacco industry leaders continue to explore options including program changes to improve the competitive position of U.S. tobacco."[21] In an April 1999 memo to U.S. tobacco growers, Philip Morris stated, "we will support the Federal Tobacco Program as long as farmers want it, but we do think it requires modifications in light of today's situation."[22]

Philip Morris's Contracting Proposal

Additional evidence of the U.S. cigarette companies' diminishing support for the U.S. tobacco program appeared in April 1999, when Philip Morris told U.S. growers that neither the tobacco program nor current U.S. tobacco harvesting and marketing practices work anymore and must be changed. According to Philip Morris, neither the tobacco sold at auction nor the excess stocks held in inventory by the U.S. tobacco program match the "narrowly defined grades and styles of flue-cured and burley tobacco" that Philip Morris needs for its "high quality" cigarettes in order to "maintain our competitiveness in the U.S. and abroad." Accordingly, the company tried to convince U.S. growers both to begin segregating the tobacco they sell into new quality categories and to switch from selling their leaf through the existing auction system to contracting directly with Philip Morris. The company argued that the U.S. cigarette manufacturers were facing as uncertain and difficult a future as growers were and that contract sales and segregating U.S. tobacco into more distinct quality grades were necessary for both their and the growers' future success. If adopted, these proposals would harm a majority of all existing U.S. growers.[23]

Segregating U.S. tobacco into additional quality grades (which requires harvesting and sorting tobacco leaf by where it appears on the stalk) increases growers' labor and production costs and could make it more difficult for the smallest farms to put together sale-sized lots of each of the different grades of tobacco, especially with the recent moves, prompted by the companies, toward preparing tobacco for sale by putting it into large-sized bales.[24] While one of the asserted advantages of direct tobacco contracting is the "more widespread adoption of cost-lowering technology," the costs of such new technology are typically beyond the means of many small tobacco farms.[25]

On the other hand, offering U.S. tobacco in more distinct quality grades would enable Philip Morris and the other cigarette companies to get the U.S. flavor or quality they and their customers desire by using smaller amounts of the very highest quality U.S. tobacco "tips" in place of larger amounts of tobacco leaf from the entire plant—and making up the difference with cheaper foreign or reconstituted tobacco. The companies' preference for top-stalk leaf for quality and low-stalk leaf for filler could also create a glut of mid-stalk leaf, which could eventually overwhelm the U.S. tobacco support program's capacity to absorb unsold tobacco quota at established minimum prices.[26,*]

The direct contracting proposed by Philip Morris could be even more harmful to U.S. growers because the other major cigarette companies would likely follow suit, thereby

* Oddly enough, Philip Morris stated that the company examined whether it could "change" its existing cigarette tobacco blends to get by without segregating U.S. tobacco into more distinct quality grades and found that option unacceptable. But Philip Morris did not explain how they have been able to get by without the distinct grades up to now, or what new circumstances require the new grade distinctions. Nor did the company explain why their current cigarette blends would have to be "changed" to use U.S. tobacco offered in the exact same quality grades growers have been

ending the current auction system and putting the entire tobacco support program at risk.[27] Rod Keugel, president of the Burley Tobacco Growers Cooperative Association, observes that "Ending the auction system has short-term appeal, but it's a danger to the price-support system…and a danger ultimately to the quota system."[28]

Philip Morris has said that it "will not need agreements with all growers to meet its needs." As part of its direct contracting proposal, the company has also been pushing tobacco program changes to make it easier to shift U.S. tobacco growing from small farms to large, such as allowing cross-country or even interstate transfers of quota.[29] According to the *Lexington Herald-Leader*, the cigarette companies have said that they favor contracts with farms that raise 20 acres or more of tobacco, which would exclude 30,000 Kentucky farm factories.[30] As Joe Teasley, a long-time grower in Tennessee, puts it, "The companies are going to make a decision about who's growing it and who's not. The little man will be left out."[31] Danny McKinney, the CEO for the Burley Tobacco Growers Cooperative Association agrees, saying, "I can't believe major companies would be out here buying from the 1,000 or even 2,000-3,000-pound grower."[32]

Even the growers who entered into contracts with the cigarette companies would not necessarily benefit from the new system. Keugel points out that "the only thing that keeps us independent is not having to answer to [the cigarette companies] directly. As long as we have an arm's-length transaction, we maintain our independence. Lose that and we become an appendage of the tobacco companies."[33] Moreover, in exchange for giving the growers the security of a production contract, the cigarette companies would likely demand lower prices than those an auction system would produce.[34] Similar shifts to direct contracting in the U.S. poultry and pork markets, for example, have resulted in sharp price reductions, among other problems for producers; and foreign experiences with direct contracting for tobacco have also brought about lower prices.[35] If similar price cuts occurred under tobacco contracting, the only way that the contracting growers could keep their profits up would be to increase the amount they produce and sell to the cigarette companies, but the tobacco program's quota limits would make that impossible.

Quota holders for each type of tobacco periodically vote on whether to stay in the program or leave it, with the next votes for flue-cured and burley in 2001. To kill the program, the cigarette companies would only need to convince growers holding a bare majority of all quota to vote against it. Accordingly, some growers fear that once extensive contracting started, the cigarette companies would use their new direct relationships with larger growers to convince the growers to abandon the U.S. tobacco support program and its quota restrictions so that the growers under contract could produce and sell more tobacco to the cigarette companies.[36]

Even if the tobacco program continued, North Carolina Agriculture Commissioner Jim Graham believes that contracting "will create even more instability in the marketplace."[37] In a careful analysis of tobacco contracting, tobacco economist William Snell found that it would not only lower prices and favor large growers over small but most likely

using, and that Philip Morris has been purchasing, for years. In fact, the growers used to segregate leaves into several different grades, but stopped when the cigarette companies showed little or no interest, bidding the same prices for each. [Joe Ward, "Philip Morris Agrees to Wait on Direct Sales: Growers Asked Firm to Explore Other Options," *Louisville Courier-Journal*, April 23, 1999.]

also reduce grower independence while increasing the cigarette companies' control, thereby creating a greater risk of market-power abuses by the companies. He also concluded that direct contracting could also reduce the amount of direct, public information on prices, quantities sold, and the like that the current auction system currently provides, and that the price-support program requires.[38]

Although the U.S. tobacco support program technically allows for direct cigarette company contracting with growers, Philip Morris has shown that it wants to use any opportunities created by its contracting proposal to implement a much wider range of even more substantial tobacco program modifications, and the strategy seems to be working.[39] For the 1999 growing season, the U.S. grower community persuaded Philip Morris to abandon its contracting plans.[40] In exchange, however, the growers agreed to improve their quality control efforts and begin segregating their tobacco leaf by stalk position, although not to the extent desired by Philip Morris. In addition, the growers have agreed to consider significantly modifying existing tobacco production and marketing practices, as well as the tobacco control program, itself.[41]

In an April 1999 follow-up letter to growers after Philip Morris agreed to postpone contracting for a year, the company submitted a list of major changes to the way tobacco is grown and marketed in the United States, including significant changes to the U.S. tobacco support program, that it believes are needed before it would completely drop its interest in direct contracting.[42] Since then, Philip Morris has continued to press for both marketing and program changes and direct contracting and has tried to secure heavily discounted prices from the cooperatives that hold the U.S. tobacco program's leaf inventories as a condition of not going forward with direct contracting next year.[43]

Consequences From Ending the Tobacco Support Program

Studies have estimated that ending the U.S. Tobacco price-support program would reduce U.S. tobacco leaf prices, thereby increasing the demand for U.S. tobacco, which would eventually increase production and sales. Although the end of the program's quota restrictions would allow existing growers to increase their production to the extent possible to make up for the lower prices, limited acreage and the associated increased production costs would make it extremely difficult for most smaller growers to come out ahead—especially since they would also have to compete successfully against larger farms that have lower production costs. Consequently, many existing small tobacco farms would likely disappear.[44]

While it is difficult to predict exactly how much leaf prices would drop and sales would increase if the tobacco program were eliminated, various tobacco economists and researchers have developed estimates based on a careful analysis of historical data and existing circumstances. For example, general studies suggest that 25 percent price reductions would increase overall U.S. tobacco leaf sales by about 36 to 62 percent, although the most recent study supports the lower figure.[45] In a 1999 study, which took into account the different domestic and global markets for burley and flue-cured tobacco, agricultural economists and tobacco specialists Blake Brown, William Snell, and Kelly Tiller calculated that the end of the tobacco program would reduce burley prices by more than 20 percent, prompting a 13 to 16 percent increase in the demand and sales of burley leaf, and flue-cured prices would drop by

about 27 percent, with increased sales of 84 to 89 percent.[46]

These calculations suggest that burley growers would, as a whole, suffer more from the end of the tobacco program because the overall increased demand for burley would not compensate for the price drop. Total U.S. burley revenues would decline. Because the demand for flue-cured leaf would increase more than its prices would drop, flue-cured growers, as a group, would do better. But many individual flue-cured growers would still be unable to expand their own production sufficiently, or at a low enough cost, to make up for the reduced prices, and many smaller-scale flue-cured growers would not be able to compete successfully against the larger farms.[47]

As the CEO of Universal Leaf Tobacco noted a few years ago, ending the U.S. tobacco program would produce “drastic changes in crop size, in where tobacco is grown.” [48] Similarly, in a roundtable discussion with growers and community leaders in Carollton, Kentucky, President Clinton observed that:

> If you dismantle this program, you would not end the production of tobacco. You would end the ability of all these family farmers to produce tobacco, and you would probably create a structure more like what you see in some parts of California [where] the cigarette companies control the farming and everybody would be a hired hand.[49]

Florida and Texas have also been mentioned as possible sites for new large tobacco farms that would produce multiple annual crops under contract with the U.S. cigarette companies.[50]

According to tobacco economist Blake Brown, the shift to low-cost production caused by the end of the tobacco program would, in the short term, cause flue-cured production declines in the Piedmont of North Carolina and Virginia but expand production in the coastal plain of the Carolinas, southern Georgia, and northern Florida, while burley production would decline in Appalachian counties and expand in central Kentucky and Tennessee and possibly in the Piedmont of North Carolina and Virginia. Once the dust had settled, however, U.S. leaf production would likely be dominated by much larger, more mechanized tobacco-growing farms under contract to the cigarette companies, including large new tobacco-growing enterprises in low-cost farming areas of states that do not currently grow tobacco.[51]

Kentucky would inevitably suffer the most from the end of the U.S. tobacco support program in terms of statewide employment and income declines because it contains over half of all U.S. farms growing tobacco, mostly small burley farms, and is the most economically dependent on tobacco.[52] The initial impact on some of the other major tobacco states would most likely be changes in the location of their in-state tobacco production and the size of the farms, with relatively small overall tobacco employment declines and only marginal adjustments in total state tobacco incomes. The longer-term effects would depend on the extent to which new tobacco production began in entirely new states. If large-scale tobacco growing began in California or Texas, for example, all of the current tobacco states would suffer substantial net losses.[53]

Even in those tobacco states that were able to retain close to current tobacco income or employment levels, some specific areas would still be severely harmed. In each tobacco state, many of the farms most likely to go out of business if the tobacco program ends are concentrated in areas or communities that currently rely most heavily on tobacco for farm income and have the weakest nonfarm

economies. These communities—in the Appalachian and Piedmont areas and ranging along the border between North Carolina and Virginia and in eastern Kentucky—could be ruined by the end of the tobacco program, unless some sort of transitional and developmental assistance were provided.[54] As Kentucky tobacco grower Larry Walden puts it, "I think the price supports for tobacco may be finished in a year or two, and if that happens, these little towns around here will just dry up and blow away."[55,*]

The end of the tobacco support program would also prompt a substantial shift of income and profits from current U.S. tobacco growers and quota holders to the U.S. cigarette companies. Tobacco economists Brown, Snell, and Tiller calculate that the loss of quota value, alone, from the end of the tobacco program would transfer over $500 million per year in yearly income from quota holders to the cigarette companies.[56] At the same time, the value of existing tobacco farmland, which would no longer have an exclusive right to grow tobacco, would decline sharply. In Kentucky, for example, farmland values would probably drop by about 10 percent and could reduce the value of the land owned by current tobacco farm owners, or their landlords, by as much as $7 billion.[57]

On the other side of the equation, Bruce Flye, president of the Flue-Cured Tobacco Stabilization Corporation, reported to Congress in 1998 that if the tobacco program collapses, "we have been told by executives of a major cigarette manufacturer that we could expect prices to drop from an average of $1.70 per pound to as low as 70 cents or 80 cents a pound," which would create a "huge windfall" for the cigarette companies of around $2 billion per year. [58] Citing a more conservative estimate by the USDA, Senator Chuck Robb (D-VA) has pointed out that eliminating the tobacco program "would result in a transfer of money from farm families to cigarette manufacturers of about $800 million annually.[59]

* These areas are also the ones that are already suffering the most from the effects of quota declines, stagnant real tobacco prices, and other ongoing changes that are forcing many small tobacco farms out of business.

The cigarette companies are for themselves. They don't look out for the growers. We're nothing but peons.[1]

—Frank Dial, North Carolina Tobacco Grower

The interests and future of tobacco growers and public health officials are inescapably intertwined in tobacco-producing states, and these two parties must continue talking to find mutually acceptable solutions.[2]

—Former President Jimmy Carter

V. Preparing for an Uncertain Future

This report documents the current problems facing U.S. tobacco growers and the breakdown of the traditional assumption that the interests of the U.S. tobacco grower and the U.S. cigarette companies are the same. The evidence is incontrovertible: (1) the tobacco growers' ongoing difficulties have been caused by actions taken by the major cigarette companies, not by declines in U.S. smoking; (2) the interests of U.S. growers now frequently conflict with the profit-maximizing goals of the cigarette companies; and (3) the future prospects for many small, family-run tobacco farms are not promising unless U.S. growers enter into new alliances to develop and implement long-term solutions.

The cigarette companies' increased manufacturing of U.S. brands overseas, heavy reliance on foreign-grown leaf in the U.S. brands made here and abroad, and extensive assistance to foreign growers (both on their own and with the major leaf dealers) are the primary cause of the problems facing U.S. tobacco growers today—and there is no indication that these trends are likely to abate in the near future. Recent cigarette company efforts to change the way tobacco is grown and marketed in the United States, including possible "reforms" to the U.S. Tobacco price support program, only threaten to make the growers' situation even worse.

Consequently, many U.S. growers are beginning to explore new options and new strategies. There are no simple solutions and there is no single magic bullet. A wide variety of alternatives must be carefully considered. In light of the sharp conflicts between the long-term interests of the U.S. tobacco growers and the U.S. cigarette companies, many growers have also begun to look for new allies, including the growing number of public health organizations who recognize that they share many common goals with most U.S. growers.

Possible Alternatives

The problems facing U.S. growers did not occur overnight and will not be solved quickly. It is critical to understand that no one solution will be best for every grower, every state, or every region. As Fred Gale of the USDA Economic Research Service points out, "a 'one size fits all' approach to addressing tobacco farmers' needs is potentially wasteful and ineffective."[3] In addition, individual proposals should not be evaluated in isolation but only as part of broader, more comprehensive

economic plans for individual communities and states.

While it is not the purpose of this report to evaluate the merits or the relative roles of the many strategies and alternatives that have been raised, presenting some of them here can help to move the necessary discussion forward. Some of the possibilities that have been raised include:

- Developing state and regional marketing plans to encourage and assist growers to make successful transitions to alternative and supplementary crops.
- Establishing a fund to buy out growers and quota holders who want to leave tobacco farming.
- Creating economic development plans to ensure that tobacco-growing states and communities have agricultural and off-farm opportunities to ensure their future economic viability.
- Developing alternative, nonharmful uses for tobacco plants, such as for bio-engineered medical products.
- Encouraging the use of U.S. tobacco over foreign tobacco by requiring that manufacturers list the percentages of each in cigarettes and other tobacco products that are made or sold in the United States.
- Developing and enforcing stronger rules concerning pesticides and other harmful chemicals and additives in tobacco leaf, cigarettes, and other tobacco products imported into the United States that match the standards for domestic tobacco.
- Creating environmental, labor, and health and safety requirements for tobacco grown for import into the United States comparable to those that apply to U.S. tobacco growing.

While growers and others frequently point out that no other legal crop can bring in as much revenue per acre as tobacco, stagnant prices, quota reductions, unused capacity, and high production costs have, in many cases, made turning to additional new crops and income sources more attractive and potentially more profitable. But there are inevitably limits to the immediate opportunities for switching from tobacco to some other crop.[4] Developing nonfarm income alternatives can also require substantial effort for tobacco growers in those rural tobacco-growing areas with already depressed economies or where nonfarming jobs are scarce or distant.[5] Tobacco growers typically identify lack of knowledge about potentially profitable options and lack of access to capital for new business ventures as major obstacles to shifting away from tobacco.[6]

Transitional strategies adapted to interested tobacco growers' specific circumstances and local or accessible markets are needed. It may also be necessary to couple such strategic guidance with technical assistance, training, and grants or low-income loans to enable more tobacco growers, or their children, who so desire to switch to other vocations or at least reduce their reliance on growing tobacco. Larger state or federal investments that go beyond providing transitional assistance and actually create new viable income alternatives for growers in those areas or communities where the fewest on-farm or off-farm alternatives exist also need to be explored.

No Quick Fix on the Horizon

As part of the legislative debate on the McCain comprehensive tobacco bill in 1998, Senators Fritz Hollings (D-SC) and Wendell Ford (D-KY) drafted a broad range of provisions to address both the short- and long-term needs of U.S. tobacco growers. The McCain bill not only provided for payments for lost quota to both quota holders and growers but also expressly provided for quota and grower buyouts as well as other assistance to help tobacco growers and their children make

the transition to other forms of income (including transition grants and college scholarships). It also included funding to assist tobacco communities and displaced tobacco industry workers.[7]

When the McCain legislation died, so did the opportunity for immediate, widespread federal assistance to tobacco growers. The subsequent November 1998 settlement agreement between the tobacco companies and 46 states did not include anything comparable. The only language in the multistate settlement agreement that related to growers was a requirement that the participating manufacturers meet with the political leadership of those states with grower communities to address the growers' economic concerns. Accordingly, the major U.S. cigarette companies held "Phase II" settlement meetings with grower representatives and officials from the major tobacco-growing states and ultimately agreed to pay $5.15 billion over the next 12 years into a National Tobacco Growers Settlement Trust to assist tobacco growers and the owners of U.S. Tobacco price support program quota allotments.[8,*]

To start, the tobacco-growing states will each receive a share of the $380 million the companies will pay in 1999 based on each state's current allotment of U.S. tobacco production under the U.S. tobacco program, with future yearly payments similarly allocated. In each state, the governor must appoint a board, with grower representation, to develop a formula for determining how much each grower or allotment holder will receive, and the boards are free to change their distribution formulas each year.[9] Virginia, for example, will be splitting its 1999 Phase II funds evenly between flue-cured tobacco quota holders and active farmers, but directing only 25 percent of the funds for burley tobacco to quota holders and 75 percent to active farmers.[10]

Kentucky plans to distribute the roughly $113 million it will receive in 1999 by the end of the year, allocating one-third to quota holders, one-third to the owners of actively farmed land, and one-third to active tobacco farmers (with people able to qualify for payments under more than one category). Because Kentucky has more than 150,000 quota holders and 20,000 tobacco growers, the average payment in 1999 should be about $640 (after administrative costs are deducted).[11] In 1999, North Carolina will distribute about $144 million to roughly 82,000 quota holders and 11,000 tobacco farmers, which suggests an average payment of a bit less than $1,500.[12] Nationwide, there are about 300,000 quota holders and 90,000 tobacco farmers, which suggests a national average Phase II payment in 1999 of roughly $950.[13]

Speaking of Phase II: "Tobacco farmers were innocent parties who shared no blame with the cigarette companies that were deliberately targeting to children and were concealing research and health information the public had a right to know. It is only right and fair that the Big Tobacco help ease the transition many farmers will go through over the next decade."

—Joe Kernan, Indiana Lieutenant Governor, Jeff Modisett, Indiana Attorney General, Letter to the Indianapolis Star, August 30, 1999

* Despite the Phase II payments and the expectation that every tobacco state will use some of its settlement funds to assist tobacco growers and their communities, some growers are planning a class action lawsuit against the cigarette companies and the state attorneys general, charging that they conspired to exclude U.S. tobacco growers from the settlement agreement and that the final agreement has harmed the value of tobacco quotas without the growers' consent. [Peter Hardin, "Tobacco Firms May Face New Litigation Fight," *Richmond Times-Dispatch*, October 16, 1999].

So far, the states seem to be allocating the Phase II funds mathematically based on how much quota a person farms or owns, rather than according to how much hardship or financial difficulty the grower or quota holder has experienced because of quota reductions. Advocating the latter approach, the *Raleigh News & Observer* has observed that the funding allocations "ought to assess the relative impact of the lost tobacco income. A farmer whose family depends entirely on his earnings from tobacco, or a widow whose inherited allotment is her lifeline, deserves to be compensated sooner and at a higher level than a businessman whose quota accounts for but a fraction of his wealth."[14]

Because the cigarette companies will pay $100 million less to the states under the Phase II agreement in the year 2000 than in 1999, the states' payments to growers and quota holders will also decline. But the cigarette company payments will increase by $120 million in 2001 to total $400 million, will annually total $500 million from 2002 to 2008, and will then drop down to $295 million for each of the final two years.* These amounts will be adjusted upward to account for inflation, but will be adjusted downward based on reductions in U.S. cigarette consumption.[15]

The Phase II agreement also provides that the amounts the cigarette companies pay will be reduced to account for any new increases in state or federal cigarette taxes or any other new government fees or financial burdens placed on the cigarette companies to the extent that the new charges against the cigarette companies are used to finance new payments or other assistance to tobacco growers or quota holders.[16] It is reasonable to conclude that the cigarette companies demanded this offset provision to try to block growers and quota holders (and state legislators and governors) from supporting new federal cigarette tax increases, the proposed federal tobacco lawsuit, or any other federal charges against the cigarette companies that might be used to finance federal quota buyouts or other additional economic or transitional assistance for growers.

David Adelman, a Wall Street tobacco analyst with Morgan Stanley Dean Witter, sees Phase II as a political strategy by the cigarette companies meant not only to appease the growers, quota holders, and especially state lawmakers but to align their interests with those of the cigarette companies.[17] Similarly, the *Lexington Herald-Leader* (Kentucky) believes that the cigarette companies have been "spooked" by the growing alliance between growers and public health groups and are making payments to growers because they are "desperate to return their political foot-soldiers to the fold. They know they will need the tobacco farmers…for future fights over regulating and taxing cigarettes."[18] As Harold Blackwell, a tobacco grower from Caswell County, North Carolina, puts it, "I don't know that Philip Morris out of the goodness of their heart gave us Phase II money. They may want something in return."[19]

The $5.1 billion in Phase II assistance over the next 12 years is no substitute for the comprehensive reform and assistance U.S. growers and their communities need. Compared with the broad-based assistance for both growers and tobacco communities in the

* The Agricultural Appropriations bill (P.L. 106-78) that was signed into law by the president on October 22, 1999, contained a provision that will direct a one-time payment of $328 million into the Phase II National Tobacco Farmer Grower Settlement Trust, with the funds becoming available in the year 2000. This funding will not trigger the Phase II offset provision, and it will be allocated to states and distributed to growers and quota holders according to each tobacco state's Phase II formulas, requirements, and restrictions. [See, e.g., Associated Press, "Senate Gives Tobacco Farmers A Hand," *Winston-Salem Journal,* August 6, 1999.]

McCain bill, Phase II is no more than a Band-Aid on a problem that requires more intensive care and comprehensive treatment. These differences prompted a *Lexington Herald-Leader* editorial during the Phase II negotiations that stated: “[I]t’s sadly evident that growers lost big last June when the tobacco bill died in the Senate…. [G]rowers, once in line for up to $28.5 billion in transition aid, now find themselves begging the cigarette companies for scraps.”[20] Moreover, federal and state legislative action (or inaction) pertaining to a range of grower-related policy proposals and issues will have a much more powerful impact than the Phase II payments on the future of American tobacco growers and U.S. tobacco farming.

New Coalitions to Implement Pro-Grower Policies and Programs

Given the major cigarette companies’ shifts to foreign leaf and ongoing attempts to change the way tobacco leaf is grown and marketed in the United States, it is not surprising that many U.S. growers and grower organizations have been rethinking their relationship with the cigarette companies and seeking out new friends and allies, including public health groups, that can help them get supportive measures passed by the U.S. Congress or tobacco state legislatures.[21]

At the same time, a growing segment of the U.S. public health community has sought to work with U.S. tobacco growers and their communities. Key representatives have recognized that U.S. tobacco growers need not be an obstacle to promoting the public health and should receive transition assistance as new efforts are undertaken to reduce the national toll of death and disease from smoking. To this end, many of these public health groups are working to direct deserved assistance to the growers and their communities to help them find alternative sources of income and otherwise adjust to the declining domestic demand for cigarette tobacco.

More and more public health advocates and U.S. growers are learning that they share important goals. For example, growers, like almost any parents, do not want their kids to smoke and the majority of growers support strong new measures to block cigarette company marketing to kids, reduce youth access to tobacco products, and otherwise prevent and reduce underage smoking.[22] On the other hand, the ingredient disclosure laws, pesticide restrictions, and other measures supported by many growers might also help to reduce smoking or otherwise improve the public health. Maintaining the U.S. price-support program for tobacco not only allows more small family farms to survive, but also keeps the cigarette companies from receiving billions of dollars in windfall profits from tobacco leaf price reductions.

The first serious efforts to establish a dialogue between tobacco growers and the public health community were prompted by former President Jimmy Carter in 1985. A grower himself, who had lost family members to tobacco use, Carter decided after leaving office that one of the first domestic tasks of the Carter Center would be to try to bridge the gap between growers and health groups by opening up dialogue in a safe environment. That year, the Carter Center brought growers and health groups together to have an open and honest dialogue for the first time.[23]

In 1989, the final report from the national Tobacco Use in America Conference stated that “any effort to reform the tobacco price support program must balance the concerns of the health community and the interests of the family tobacco farmer,” and urged increased assistance to U.S. growers who stop growing tobacco, including grants and no-interest loans in exchange for retiring

quota.[24] In 1993, a national public health conference on tobacco use—sponsored by the American Medical Association, the U.S. Centers for Disease Control and Prevention, the American Heart Association, and the American Cancer society, among others—issued a report that included a thorough discussion of the farming issues relating to U.S. tobacco use and recommended increased assistance to U.S. tobacco growers, as well as new requirements that cigarette labels disclose their U.S. and foreign leaf content.[25] In 1995, the Coalition on Smoking OR Health publicized the facts that U.S. growers were receiving a shrinking portion of each dollar spent on cigarettes, and supported government efforts to help tobacco growers and their communities reduce their dependence on tobacco production, including buyouts, transitional assistance, and economic diversification planning.[26]

> "However 'family values' is defined, our [tobacco] farm families epitomize the best. They are hard-working, self-motivated, and self-sufficient. Seeing them survive and prosper should be a concern to us all and an aggressive state and federal agricultural policy should reflect that concern."
>
> ***—Tobacco Use: An American Crisis, Final Conference Report and Recommendations From America's Health Community, 1993***

Discussions between public health advocates and growers also began in several states; and, in 1994, Ann Northrup, now a U.S. representative from Kentucky, established the Coalition on Health and Agricultural Development to serve as a formal vehicle in that state for developing and promoting the shared or mutually supportive goals of growers and public health groups.[27] In 1996, the Robert Wood Johnson Foundation helped to establish the Southern Tobacco Communities Project to bring even more growers and public health groups together. [28]

Although breaking through decades of mistrust and misunderstanding was not easy, the public health advocates and U.S. tobacco growers soon began to develop ways in which the two groups could work cooperatively toward mutually acceptable goals. On the national level, the growers and health advocates spoke openly about how to meet the needs of U.S. growers and dependent communities in the event that national tobacco control legislation was enacted. Working together, in 1998 the Southern Tobacco Communities Project, Concerned Friends for Tobacco, several grower organizations, the American Heart Association, the American Cancer Society, the Campaign for Tobacco-Free Kids, and others developed a set of shared national Core Principles that expressed a mutual commitment to both reduce disease caused by tobacco products and ensure the future prosperity and stability of the American tobacco farmer, the tobacco farm family, and tobacco farming communities.

In March 1998, the Core Principles were formally announced in the House Agriculture Committee room of the U.S. House of Representatives, endorsed by more than 40 agricultural, grower, and health organizations, including the just-listed organizations as well as the Flue-Cured Tobacco Cooperative Stabilization Corp., the Burley Tobacco Growers Cooperative, the Virginia Farm Bureau, the Virginia Tobacco Growers Association, the National Black Farmers Association, the Christian Broadcast Network, the Interreligious Coalition on Smoking OR Health, and the Carter Center.[29]

Now more than 80 grower, farming, public health, and other organizations have endorsed the 10 Core Principles, in which health groups have pledged support for

measures to assist tobacco growers and tobacco growers have pledged support for measures to reduce the incidence and harms of tobacco use, including support for the U.S. Food and Drug Administration's assumption of authority over manufactured tobacco products. [A copy of the Core Principles with a list of endorsing organizations and individuals is attached as Appendix II.]

On the day the Core Principles were first released publicly, J. T. Davis, secretary of Concerned Friends of Tobacco, a political action committee representing Virginia growers, stated:

> Today is truly an historic day for the tobacco grower, the tobacco grower community, and the public health community. Two entities that have long viewed each other as adversaries have come together after many months of civil dialogue with a plan to enhance the public health of this nation and at the same time develop a plan to take the tobacco grower and the tobacco farm communities into the 21st century and to sustain a healthy economy.[30]

Echoing these sentiments on behalf of the public health groups endorsing the Core Principles, Bill Broome, a board member of the American Heart Association (and whose father and uncles were tobacco farmers), noted that "the seriousness of the tobacco epidemic and the need for strong policies and programs to discourage and prevent the use of tobacco has put the tobacco farmer in a difficult situation with difficult choices" and declared that "we must not go forward without addressing the health, economic, and social needs of American tobacco farm communities."[31]

The public health groups' commitment to work with U.S. growers toward mutual goals sharply contrasted with the U.S. cigarette companies' failure either to include any U.S. growers in their original settlement negotiations with the state attorneys general or to provide for any measures to assist growers in the initial June 20, 1997, settlement agreement.[32]

This contrast continued after the June 1997 settlement was superseded by the Senate debate over the McCain comprehensive tobacco bill. Working together, the public health groups and U.S. growers were able to make sure that the McCain bill included a range of measures to help U.S. growers and their communities.[33] The U.S. cigarette companies did not promote the various grower provisions in the original McCain bill nor did they oppose the alternative provisions that would have eliminated them.[34] In their effort to defeat the entire bill, the companies tried to hide behind the tobacco farmers once again, claiming that the public health provisions would hurt U.S. tobacco growers.[35] As Andrew Shepherd, a Virginia tobacco grower and vice president of Flue-Cured Tobacco Cooperative Stabilization Corporation, said at the time, "They're trying to use us as human shields, while trying to manipulate us…. I don't buy it."[36]

Following the state tobacco settlements, U.S. tobacco growers and public health groups have had a new opportunity to work together to advocate jointly that their states use a significant portion of their settlement funds both to promote public health by preventing and reducing tobacco use and to help tobacco growers and their communities through this difficult period. As a result of such joint efforts, Virginia has allocated 50 percent of its tobacco settlement receipts (about $65 million

"The industry has never shown much concern for tobacco farmers, and it is hypocritical for it to raise the specter of suffering farmers and dying small towns in an effort to protect its own bottom line."

—Raleigh News & Observer, *April 1998*

per year) to help its tobacco growers and tobacco communities.[37]

Similar cooperation between growers and public health advocates in North Carolina is supporting an allocation of 25 percent of its settlement funds for public health (about $40 million per year) and 75 percent (about $120 million per year) to help tobacco growers and their communities. The North Carolina House of Representatives has already passed the measure, but the state's Senate will not take action until next year.[38] In Kentucky, farming and health groups have created a Health and Agriculture Forum and have reached an understanding that funds from the state's tobacco settlement should be allocated both to new measures to assist tobacco growers and to various public health initiatives, including efforts to prevent and reduce smoking among youth.[39] To various degrees, tobacco growers and public health groups have been working together to pursue their shared goals in each of the other tobacco states, as well.

"Tobacco farmers and tobacco state officials need to remember who their real friends have been [the public health groups]. And they need all the friends they can get."

—Lexington Herald-Leader, *December 18, 1998*

Beyond the battles over settlement funding, U.S. tobacco growers and public health organizations will have numerous other opportunities to work together in the coming years. U.S. growers face both immediate difficulties and an uncertain and precarious future, all caused largely by the decisions and actions of the major U.S. cigarette companies. When the U.S. companies relied almost exclusively on U.S. tobacco and primarily served the U.S. market, shared interests may have created some foundation for mutual loyalty and reciprocated support. But now that the U.S. companies use more foreign tobacco than domestic and sell more cigarettes overseas than at home, the growers' and the companies' interests have sharply diverged and frequently conflict. Time and again, the cigarette companies have shown that they are happy to forsake U.S. growers for foreign leaf and higher profits. As increasing numbers of American growers are now recognizing, working with the public health community may offer growers their best chance both to influence the ongoing changes to the domestic and worldwide cigarette and tobacco markets and to successfully adapt to them.

Appendix I

Foreign Facilities of U.S. Cigarette Companies and Leaf Dealers

[Prior to R.J. Reynolds's Sale of Its Foreign Facilities to Japan Tobacco, Inc.]

Country	Philip Morris	R.J. Reynolds	BAT (Brown & Williamson)	Universal	Dimon	Standard
Andorra	L	L				
Angola			X			
Argentina	X	L	X	X	X	X
Aruba	L					
Australia	X	L	X			
Austria	L	L				
Bangladesh			X		X	
Barbados			X			
Belgium		X	X	X		
Bolivia	L					
Brazil	X	L	X	X	X	X
Bulgaria			X		X	
Cambodia			X			
Cameroon			X			
Canada	X	X	X	X	X	X
Canary Islands		X	X			
Chile			X		X	
China		L	X	X	X	X
Colombia			X			
Congo			X		X	
Costa Rica	X		X			
Croatia	L	L				
Curacao	L					
Cyprus		X	X			
Czech Republic	X	X	X			
Denmark			X			
Dominican Republic	X	L		X		
Ecuador	X		X			
Egypt	L	L				
El Salvador			X			
Fiji		L	X			
Finland	L	X	X			
France		X	X	X		
Germany	X	X	X	X	X	X
Ghana			X			

X = Facility owned wholly or in part. L = License agreement.

Country	Philip Morris	RJ Reynolds	BAT (Brown & Williamson)	Universal	Dimon	Standard
Greece	L	L	X		X	X
Guatemala	X		X	X	X	
Guinea		L				
Guyana			X			
Honduras			X			X
Hong Kong	X	X	X	X	X	X
Hungary	X	X	X	X		
India	X		X		X	X
Indonesia		L	X	X	X	
Ireland			X			
Italy	L	X	X	X	X	X
Ivory Coast	L					
Jamaica			X			
Japan	L	X	X			
Jordan	L	L				
Korea, South	X	X	X			
Kyrgyzstan				X	X	
La Reunion	L		X			
Liechtenstein						X
Lithuania	X					
Macedonia	L	L			X	X
Malawi			X	X	X	X
Malaysia	X	X	X			
Malta	L		X			
Mauritius			X			
Mexico	X	L	X	X	X	
Mozambique					X	
Myanmar			X		X	
Netherlands	X	X	X	X	X	
New Zealand		L	X			
Nicaragua			X			
Nigeria			X			
Pakistan	X		X			
Panama	X		X			
Papua New Guinea			X			
Paraguay				X		
Peru		L				
Philippines	L	L		X	X	
Poland	X	X	X	X	X	
Portugal	X	X				
Puerto Rico		X				
Romania	X	X	X	X	X	
Russia	X	X	X	X	X	X

X = Facility owned wholly or in part. L = License agreement.

Country	Philip Morris	RJ Reynolds	BAT (Brown & Williamson)	Universal	Dimon	Standard
Senegal	L					
Sierra Leone			X			
Singapore		X	X			
Slovakia			X			
Slovenia		X	X			
Solomon Islands			X			
South Africa	L	L	X		X	
Spain	L	L	X	X		X
Sri Lanka			X		X	
Surinam			X			
Sweden		X				
Switzerland	X	X	X	X	X	X
Taiwan		X	X			
Tanzania		X		X	X	X
Thailand		X	X		X	X
Trinidad			X			
Tunisia		X				
Turkey	X	X	X		X	X
Uganda			X			
Ukraine	X	X	X			
United Kingdom	X	X	X	X	X	X
United States	X	X	X	X	X	X
Uruguay	X					
Uzbekistan			X			
Venezuela	X		X			
Vietnam	X	X	X		X	
Yugoslavia		L				
Zambia			X		X	
Zimbabwe			X	X	X	X

X = Facility owned wholly or in part. L = License agreement.

Source: Tobacco Reporter, *1999 Global Tobacco Industry Guide*, September 30, 1998.

Appendix II

Core Principles Statement Between the Public Health Community and the Tobacco Producers' Community

In the spirit of cooperation and with a commitment towards:

- Reducing disease caused by tobacco products; and
- Ensuring the future prosperity and stability of the American tobacco farmer, the tobacco farm family, and tobacco farming communities;

the undersigned organizations and individuals call on the President of the United States, the Congress of the United States, and all State Attorneys General to commit to supporting and enacting effective tobacco legislation and policies that include the following points of agreement.

That on issues related to agricultural production of tobacco there is agreement:

1. That a tobacco production control program which limits the supply and which sets a minimum purchase price is in the best interest of the public health community and the tobacco producer community. From a harm reduction standpoint, it is in the best interest of the public health community to support enhanced assurance of quota stability for domestic production of tobacco.
2. That any cost associated with the administration or operation of a tobacco program be guaranteed to be paid for under any legislative proposal, and that the federal government no longer bear the cost for the administration or operation of such a program.
3. That there be greater cooperation between the tobacco growing community and the public health community to ensure that quality control and health and safety standards are maintained in the production of tobacco, both domestically and abroad, and that industry information and research should be made available for public review. Agencies with public health responsibility, including the Food and Drug Administration (whose authority over manufactured tobacco products should not extend to on-farm tobacco production), should work cooperatively through structures already in place in the Department of Agriculture and Environmental Protection Agency so as not to extend any additional control and bureaucracy over the on-farm production of tobacco.
4. That tobacco quota holders and tobacco lease holders should be given the opportunity to have their quotas compensated for at a fair and equitable level, and that the protection of tenant farmers be given special consideration as part of this process to ensure that they are not adversely affected.
5. That a significant amount of money be allocated so that tobacco growing states and communities have options and opportunities to ensure their economic viability into the 21st century. There must be signif-

icant involvement of tobacco growing communities in determining the allocation of these funds, and decision making for plans to enhance the economic infrastructures of these communities should be governed primarily through community-based input. Agricultural-based development in particular ought to be given a high priority.

That on issues related to public health there is agreement:

1. That it is in the best interests of the public health community and the tobacco producer community that the FDA should have authority to establish fair and equitable regulatory controls over the manufacture, sale, distribution, labeling (including country of origin) and marketing of tobacco products, both domestic and imported, comparable to regulations established for other products regulated by the FDA. Such regulations should have as their goal the protection of public health and the assurance that users of tobacco products are provided with full and complete information about the products they are using. In order to accomplish this goal, industry information and research should be made available for public review.
2. That there should be strong complementary federal, state and local laws which guarantee that tobacco products are not marketed, advertised or otherwise made available to anyone under the age of 18.
3. That prohibition of the use of tobacco products by informed adults of legal age is not a goal of the public health advocates or tobacco producers.
4. That there should be mechanisms in place to prevent the importation of foreign tobacco, whether in raw agricultural leaf, reconstituted or homogenized leaf, tobacco by-products, or any other form or alteration of tobacco, that does not meet pesticide residue requirements and other quality controls required for domestically grown and produced tobacco.
5. That if there is an increase in the federal excise tax in any legislative proposal, a portion of the tax would be used for carrying out public health initiatives, and a portion of the tax would be used to assist farmers and their communities in addressing their economic dependence on tobacco.

Signatories

National

American Academy of Addiction Psychiatry
American Association for Respiratory Care
American Cancer Society
American College of Cardiology
American College of Chest Physicians
American College of Preventive Medicine
American Heart Association
American Public Health Association
American School Health Association
Americans for Non-Smokers Rights
Association of Schools of Public Health
Association of Teachers of Preventive Medicine
Campaign for Tobacco-Free Kids
Carter Center
Former President Jimmy Carter
Christian Broadcast Network
College on Problems of Drug Dependence
Family Voices
Federation of Behavioral, Psychological & Cognitive Sciences
Interreligious Coalition on Smoking OR Health
National Association of Local Boards of Public Health
National Black Farmers Association
National Hispanic Medical Association
National Society for Public Health Education
Oncology Nursing Society
Partnership for Prevention
Dr. Pat Robertson
Rural Advancement Foundation International

Regional

American Cancer Society, Mid-South Division (AL, AR, LA, KY, MS, TN)
American Heart Association Ohio Valley Affiliate (KY, OH, WV)
Burley Stabilization Corporation
Burley Tobacco Growers Cooperative, Inc.
Capital Area Society for Public Health Education
Commodity Growers Cooperative Association
Flue Cured Tobacco Stabilization Corporation
New England Society of Public Health Education

State

Alabama Attorney General Bill Pryor
Georgia Public Health Association
American Lung Association, KY
Center for Sustainable Systems, KY
Kentucky Attorney General Ben Chandler
Coalition for Health & Agricultural Development, KY
Daniel E. Kenady, MD, UKMC
Kentucky Academy of Family Physicians
Kentucky Action (ACS, AHA, ALA, KMA…)
Kentucky Health and Agricultural Forum
Sierra Club, Cumberland Chapter, KY
Michigan Farmers Union
New Jersey Society for Public Health Education
Greater New York Society for Public Health Education
North Carolina Society for Public Health Education
North Carolina Council American Cancer Society
Ohio Society for Public Health Education
South Carolina Public Health Association
South Carolina Project Assist
Greater Knoxville Coalition on Smoking or Health
Tennessee Tobacco Working Group
Texas Society for Public Health Education
Albemarle Co. (VA) Medical Society
Allies for Tobacco, Inc., VA
American Cancer Society, Virginia Council
Concerned Friends for Tobacco, VA
Halifax County Board of Supervisors, VA
Medical Society of Virginia
Virginia Agricultural Growers Association
Virginia Dark-Fired Growers Association, VA
Virginia Farm Bureau
Virginia General Assembly
Virginia Public Health Association
Virginia Sun-Cured Growers Association
Virginia Tobacco Growers Association

Appendix III

The U.S. Tobacco Price-Support Program

The U.S. Department of Agriculture (USDA) has administered the Tobacco Price-Support Program since the early 1930s. Although the program has undergone numerous changes, its underlying rationale remains: to support and stabilize tobacco prices for farmers. For each type of tobacco, quota holders vote every three years on whether to continue in the program, which has two key components: (1) a marketing quota system that forbids any commercial growing of the covered types of tobacco in the United States by anyone other than those growers holding program quota rights, and that limits the amount of tobacco each participating grower can sell; and (2) a price-support system that guarantees participating growers a minimum price for their product. More than 90 percent of burley and flue-cured tobacco quota holders have consistently voted to continue the program. The next referendum for burley and flue-cured quota holders will occur in 2001.

Marketing Quotas

In return for receiving a guaranteed minimum price for their tobacco, farmers have agreed to abide by a system of marketing quotas, which limits the overall supply, or quota, of tobacco that can be grown and sold (which helps to keep prices higher). Each year, the USDA sets the overall quota for each type of tobacco based on a formula that includes:

- The purchase intentions of cigarette manufacturers, which are submitted annually to the USDA (any cigarette company that fails to purchase at least 90 percent of its declared intentions must pay severe penalties);
- Average annual exports for the three previous years; and
- The amount of tobacco needed to reach a specific reserve stock level—15 percent of the effective quota, or a minimum of 100 million pounds of flue-cured and 50 million pounds of burley.

The USDA secretary can then adjust the results of this formula up or down by no more than 3 percent.

In the past, the tobacco production quotas were directly linked to specific farmland, meaning that growers had to farm the quota land itself to produce its allocated share of the overall quota. Today, landowners with quota rights can sell or rent all or part of their quotas (i.e., the rights to produce a certain amount of tobacco) separately from their farm land, as long as it is sold to an active tobacco farmer within the same county—with cross-county sales permitted in Tennessee for burley tobacco. Growers who do not hold quota rights typically have to pay 40 to 50 cents per pound to rent them. About one-third of all flue-cured tobacco is grown by quota holders, as is roughly 60 percent of burley tobacco.

Price Supports

Each year, the USDA announces a support price for each type or grade of tobacco covered under the program. If leaf buyers do not equal or exceed the government rate, growers can choose to sell their tobacco to a cooperative association instead, which buys it at the

support price with money borrowed from the Commodity Credit Corporation (CCC). The association then re-dries, packages, stores, and eventually sells the tobacco, with the proceeds going to repay the loan from the CCC.

Who Pays for the Program?

In 1982, the No-Net-Cost Tobacco Program Act changed the program so that taxpayers continued to be responsible for the administrative costs of the program, but were no longer responsible for any losses suffered when the price of tobacco fell below the level set by the program. The participating growers and buyers (e.g., the cigarette companies) now finance the price-support program by annually contributing to a fund that covers any losses suffered by the cooperative associations as a result of their support-price tobacco purchases. As a result of the Omnibus Budget Reconciliation Acts of 1990 and 1993, required tobacco growers and manufacturers also pay 1 percent of the support price on every pound of tobacco leaf sold in the United States to help reduce the federal budget deficit.

Primary Sources

Tom Capehart, USDA Economic Research Service, "The Tobacco Program: A Summary and Update," Special Report, *Tobacco Situation and Outlook,* April 1997, www.econ.ag.gov/Briefing/tobacco/.

Jasper Womach, U.S. Congressional Research Service, *Tobacco Price Support: An Overview of the Program,* October 2, 1997, www.econ.ag.gov/Briefing/tobacco/.

Jasper Womach, U.S. Congressional Research Service, "Tobacco-Related Programs and Activities of the U.S. Department of Agriculture: Operation and Cost," June 22, 1999, www.econ.ag.gov/Briefing/tobacco/.

Secondary Sources

A. Blake Brown, William Snell, and Kelly Tiller, "The Changing Political Environment for Tobacco—Implications for Southern Tobacco Farmers, Rural Economies, Taxpayers and Consumers," paper presented at the Southern Agricultural Economics Association annual meeting, Memphis, Tennessee, February 2, 1999, www.uky.edu/Agriculture/TobaccoEcon/.

Verner Grise, USDA Economic Research Service, *Tobacco: Background for 1995 Farm Legislation,* Agricultural Economic Report Number 709, April 1995.

Jasper Womach, Congressional Research Service, *Compensating Farmers for the Tobacco Settlement,* July 6, 1998, www.senate.gov/~dpc/crs/.

Appendix IV

Internet Sources of Additional Information

The following websites provide enormous amounts of information on tobacco growing, cigarette manufacturing, and related issues. Many of the source documents used in this report can be found at these websites.

Government Data and Information Sources

Tobacco Briefing Room
Economic Research Service
U.S. Department of Agriculture
[*Tobacco Situation & Outlook,* data, etc.]
www.econ.ag.gov/Briefing/tobacco

Tobacco Group
Foreign Agricultural Service
U.S. Department of Agriculture
[*Tobacco: World Markets & Trade,* etc.]
www.fas.usda.gov/cots/tobacco.html

Farm Service Agency
U.S. Department of Agriculture
[USDA tobacco press releases]
www.fsa.usda.gov

Food and Agriculture Organization
United Nations
[World trade and production data]
http://apps.fao.org/

World Trade Organization (WTO)
www.wto.org

U.S. Tobacco Auction Reports
Agricultural Marketing Service
U.S. Department of Agriculture
www.ams.usda.gov/tob/mncs

National Agricultural Statistics Service
U.S. Department of Agriculture
www.usda.gov/nass

Research and Analysis— U.S. Tobacco Growing

Tobacco Economics Online
Prof. William Snell
Department of Agricultural Economics
University of Kentucky
www.uky.edu/Agriculture/TobaccoEcon

Tobacco Publications
Prof. A. Blake Brown
Department of Agricultural Economics
North Carolina State University
www.ag-econ.ncsu.edu/faculty/brown

Tobacco
College of Agricultural & Environ. Sciences
University of Georgia
www.griffin.peachnet.edu/caes/tobacco

Agricultural Economics Journal
www.elsevier.com/homepage/sae/econbase/agecon

Tobacco Industry Journals

Tobacco Reporter
www.tobaccoreporter.com

Tobacco International
[No website]

Tobacco Journal International
www.tobaccojournal.com

TobaccoAsia
www.tobaccoasia.com

State Newspapers Covering Growers Issues

Tobacco News
Richmond Times-Dispatch (VA)
www.gatewayva.com/rtd/special/tobacco

Tobacco News
Winston-Salem Journal (NC)
www.journalnow.com/news/index/business_tobacco.html

Raleigh News-Observer (NC)
www.news-observer.com

Lexington Herald-Leader (KY)
www.kentuckyconnect.com/index.htm

Louisville Courier-Journal (KY)
www.courier-journal.com

The State (SC)
www.thestate.com/

The Commercial Appeal (TN)
www.gomemphis.com/

Nashville Tennessean (TN)
www.tennessean.com/

Atlanta Journal-Constitution (GA)
www.accessatlanta.com/partners/ajc/

Tobacco Grower Organizations

Flue-Cured Tobacco Cooperative
[Scoop Newsletter, etc.]
www.ustobaccofarmer.com

Burley Tobacco Growers Cooperative
www.burleytobacco.com
International Tobacco Growers Association
www.tobaccoleaf.org

Grower Assistance Organizations

Southern Tobacco Communities Project
[Core Principles, etc.]
www.virginia.edu/~envneg/tobacco

VA Rural Economic Analysis Program
www.reap.vt.edu/reap

Tobacco Project
Rural Advancement Foundation Int'l—USA
[Tobacco Communities Project Newsletter, etc.]
www.rafiusa.org/sustainable/tobacco

Kentucky Farm Bureau
www.kyfb.com/

Virginia Farm Bureau
www.vafb.com/
North Carolina Farm Bureau
www.ncfb.com/

South Carolina Farm Bureau
www.scfb.com/

Tennessee Farm Bureau
www.tnfb.com/

Georgia Farm Bureau
www.gfb.org/

Florida Farm Bureau
www.fb.com/flfb/

Tobacco Company Information

EDGAR Database
U.S. Securities & Exchange Commission
[Annual and quarterly company reports]
www.sec.gov

Philip Morris Corporate Website
www.philipmorris.com

R.J. Reynolds Corporate Website
www.rjrt.com

Brown & Williamson Corporate Website
www.brownandwilliamson.com

Liggett Group Corporate Website
www.liggett.net

Dimon Corporate Website
www.dimon-inc.com

Standard Commercial
[No corporate website]

Universal Corporate Website
www.universalcorp.com

Tobacco Information Service
Investor Responsibility Research Center
www.irrc.org/profile/tis/tishome.htm

Japan Tobacco Corporate Website
www.jtnet.ad.jp

Tobacco Company Documents

Tobacco Archives (links to all doc sites)
www.tobaccoarchive.com

Philip Morris Document Website
www.pmdocs.com

R.J. Reynolds Document Website
www.rjrtdocs.com

Brown & Williamson Document Website
www.bw.aalatg.com

Lorillard Document Website
www.tobaccoarchive.com

Tobacco Institute Document Website
www.tobaccoinstitute.com

Tobacco Settlements and Phase II

National Association of State Attorneys General
[Text of multistate settlement agreement, etc.]
www.naag.org

National Governors Association
[State tobacco settlement information]
www.nga.org/Health/Tobacco.htm

The Tobacco Settlement
USDA Economic Research Service
www.econ.ag.gov/whatsnew/issues/tobacco
[could not load]
Campaign for Tobacco-Free Kids
[Info on settlement and states' use of funds]
www.tobaccofreekids.org

Kentucky Phase II Settlement Trust
http://kytobaccotrust.state.ky.us/

N.C. Phase II Tobacco Settlement Administration
www.phase2.wcsr.com

Information on Grower-Related Issues and Policies

"Made in the USA" Standards & Enforcement
U.S. Federal Trade Commission
www.ftc.gov/os/1997/9712/epsmadeusa.htm
www.ftc.gov/bcp/conline/pubs/buspubs/madeusa.htm

Tobacco, Farmers, and Pesticides
Pesticide Action Network North America
www.igc.org/panna/resources/documents/tobacco.dv.html

Aflatoxin, Tobacco Leaf, and Cancer
www.medscape.com/medscape/GeneralMedicine/journal/1999/v01.n08/mgm0830.lane/mgm0830.lane.html [requires password]

Nitrosamine-Free Tobacco (Star Scientific, Inc.)
www.starscientific.com

Data on Number of Tobacco Industry Workers
Annual Surveys of Manufactures
U.S. Department of Commerce
www.census.gov/prod/www/abs/industry.html

Congressional Research Service (CRS) Reports
www.senate.gov/~dpc/crs/reports/rep-subj.html

U.S. Congress & Legislation Information
http://thomas.loc.gov/

U.S. Food & Drug Agency & Tobacco Products
www.fda.gov/opacom/campaigns/tobacco.html

Other Tobacco News and Research Sources

Yahoo Tobacco News
http://biz.yahoo.com/news/tobacco.html

Tobacco Control Journal
www.bmjpg.com/data/tob.htm

Endnotes

Introduction

[1] *Steven Ginsberg,* "Tobacco Growers Feel the Heat: Livelihoods at Risk as Companies Turn to Cheaper Imports, Growers Say," *Washington Post,* January 2, 1999.

[2] Steven Ginsberg, "Tobacco Growers Feel the Heat: Livelihoods at Risk as Companies Turn to Cheaper Imports, Growers Say," *Washington Post,* January 2, 1999.

[3] *Philip Morris Constituency Group: Agricultural, Plant Community, Government, and Public Affairs—An Integrated Approach,* undated [Philip Morris Document No. 2058326653 et seq., www.pmdocs.com].

[4] See, e.g., J. Phil Carlton, "Statement by the Tobacco Industry in Response to Senate Commerce Committee Tobacco Legislation," issued on behalf of Philip Morris Incorporated, R.J. Reynolds Tobacco Company, Brown & Williamson Tobacco Corporation, Lorillard Tobacco Company, and the United States Tobacco Company, March 30, 1998; Steven F. Goldstone, "Remarks of Steven F. Goldstone, Chairman and CEO, RJR Nabisco," Washington Press Club, Washington, D.C., April 8, 1998.

[5] See, e.g., Remarks by William I. Campbell, President and CEO Philip Morris U.S.A., Philip Morris's "Tobacco and the 103rd Congress" conference, Charlotte, North Carolina, May 16, 1993 [Philip Morris Bates No. 2056621025 et seq.]; "Tobacco in Perspective and the U.S. Grower—A Manufacturer's Point of View," Remarks for David L. Milby, vice president, Leaf, at the Burley Agricultural Leadership Development Program, Louisville, Kentucky, February 9, 1993 [Philip Morris Bates No. 2056515751 et seq.].

[6] U.S. Department of Agriculture (USDA), *1997 Census of Agriculture,* March 1999, and earlier editions, United States Data Table 1, www.nass.usda.gov/census. See also Tom Capehart, USDA Economic Research Service, Special Article, "U.S. Tobacco Farming Trends," April 1999, www.econ.ag.gov/Briefing/tobacco.

[7] U.S. Department of Commerce, Bureau of the Census, *1996 Annual Survey of Manufactures: Statistics for Industry Groups and Industries,* February 1998, and prior editions, www.census.gov/prod/www/abs/industry.html or www.census.gov/prod/3/98pubs/m96-as1.pdf.

[8] Company annual reports and filings with the U.S. Securities and Exchange Commission (SEC).

[9] See, e.g., Letter from Steven C. Parrish, Senior Vice President for Corporate Affairs, Philip Morris, to The Honorable J. Phil Carlton, January 14, 1999; Keynote Address by Dave Milby, Vice President, Leaf, Philip Morris U.S.A., Burley Auction Warehouse Association Meeting, Lexington, Kentucky, June 7, 1994 [Philip Morris Document No. 2058187827 et seq. at 2058187842]; Philip Morris, "Partnering Arrangement Between Tobacco Farmers and Philip Morris," handout at meeting with flue-cured growers, Lake Lanier, Georgia, April 20, 1999. See also Chip Jones, "Flue-Cured Leaf Quota Cut By 18 Percent," *Richmond Times Dispatch,* December 16, 1998.

[10] USDA Economic Research Service, "Tobacco Briefing Room" website, www.econ.ag.gov/Briefing/tobacco, Table 1, with prior-year data from Laverne Creek, Tom Capehart, and Verner Grise, USDA Economic Research Service, *U.S. Tobacco Statistics, 1935-1992,* Statistical Bulletin No. 869, April 1994.

[11] See, e.g., Credit Suisse First Boston Corporation, "Sensitivity Analysis on Cigarette Pricing Elasticity," Equity Research Memorandum, December 21, 1998; D. Ress, "Philip Morris: Worst of Sales Slide Is Over," *Richmond Times Dispatch,* April 30, 1999, A1.

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3. To escape regular tariffs or duties, NAFTA requires that the non-NAFTA leaf in any Mexican-made cigarette imports (i.e., the tobacco leaf in the cigarettes that is not from Mexico, Canada, or the United States) not exceed 9 percent of the total value of the cigarettes. USDA Foreign Agricultural Service (FAS), "NAFTA Agriculture Fact Sheet: Rules of Origin," April 1998, www.fas.usda.gov. Given that leaf costs typically constitute only a small fraction of total cigarette production costs—and that any imported Mexican-made U.S. brands would likely include some Mexican and U.S. tobacco leaf (which could be freely brought into Mexico)—it would be fairly easy for the U.S. cigarette companies to abide by this 9 percent limit if they decided to increase their production of cigarettes in Mexico for import into the United States. In fact, a small amount of cigarettes made in Mexican facilities owned by the U.S. cigarette companies is already imported into the United States. FAS, U.S. Trade Reports for Mexico.

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Chapter III

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