Tobacco in Transition: Issues Facing Burley Growers and Communities

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Tobacco growers, and rural communities in which tobacco production accounts for a substantial portion of farm income, face significant challenges at the start of the twenty first century from economic restructuring within the tobacco sector. In the next few minutes, I will summarize some of the major issues affecting the Burley Belt.

Although North Carolina is best known for its flue-cured tobacco, the western counties produce burley almost exclusively (see Figure 1). I will be drawing on two areas where I have lived and worked to illustrate my discussion. I wrote my doctoral dissertation on the historical geography of tobacco in Madison County, North Carolina, and I now live in Allen County, Kentucky. Both counties are within what could be considered the core region of burley production. Burley is produced on many farms, usually in relatively small quantities—it is a staple crop of the family farm system. When I selected Madison County as a study area, it had more people involved in tobacco production than any other North Carolina county.

The photographs in Figures 2 and 3 will give you a feel for the two areas. Madison

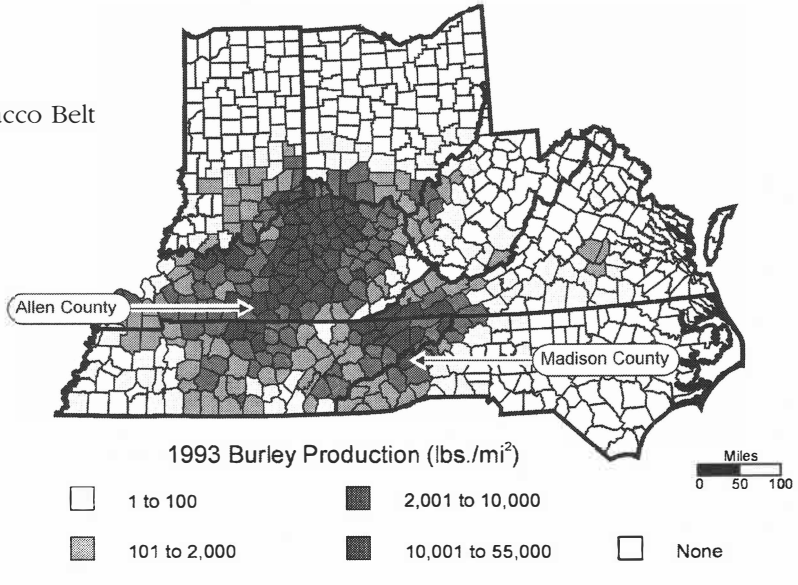

Figure 1. The Burley Tobacco Belt

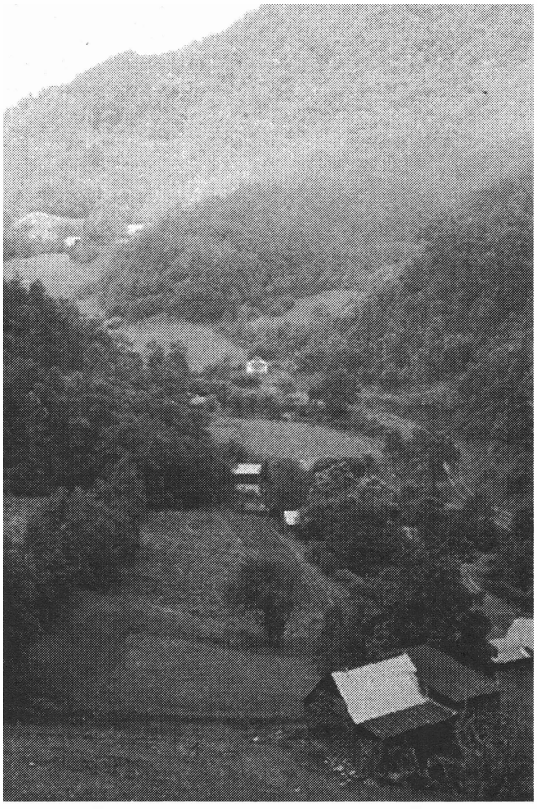

Figure 2. Madison County, North Carolina

County is located in one of the highest sections of the Appalachian Mountains, on the North Carolina - Tennessee border. Tobacco is grown in very small plots, usually in valley bottoms or on ridge tops. When I first started looking at this area in the early 1990s, 80% of farms grew tobacco and tobacco accounted for two-thirds of farm income. As of the most recent agricultural census, the percentage of farms growing tobacco had dropped to 64%. Allen County is in the rolling hills of the karst plain of south-central Kentucky. About half of the farms in this area grow tobacco. The average quota is about 4500 pounds.

Marketing

The biggest issue facing burley growers today is marketing. Farmers face an immediate choice between disposing of their crop through the traditional auction sale and committing their tobacco for sale to a specific company with which they sign a marketing contract. But they also face long-term consequences of their choice between these two marketing systems. Auction sales have been not only the norm but

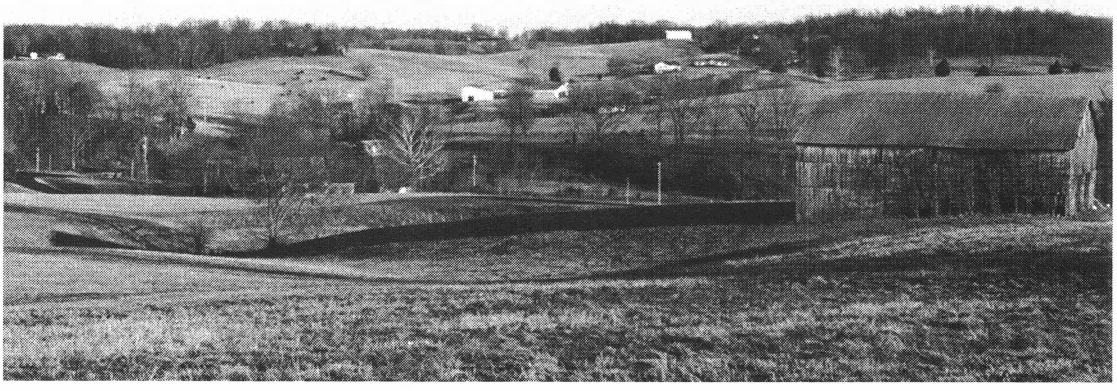

Figure 3. Allen County, Kentucky

also the rule for over sixty years. Auctioneers were used in tobacco warehouses as early as the 1820s to spur competition among buyers, but the modern system of tobacco markets dates to the establishment of the federal tobacco program during the Great Depression. Much of the tobacco program is implemented at auction warehouses, where USDA graders act as independent judges of tobacco quality. They determine the grade for each lot, which in turn determines the support price for which the leaf is eligible if not auctioned at a higher price. The tobacco program largely achieved its initial goal of stabilizing tobacco prices and has historically been an important factor in enabling small-scale growers to remain in production. Because of the intimate connection between auction sales and the tobacco program, and the role both have played in keeping burley a small producer commodity, the current auction system enjoys the adamant support of some producers, particularly smaller ones. As one Kentucky grower told me while surveying the short rows of tobacco set out in a cavernous and nearly empty warehouse, "I'll stick with the program and when the program goes away, I'll quit. The program's always been good to me." For this grower, selling at auction was a symbolic act as much as an economic one, for his few thousand pounds of leaf would do little by itself to keep this warehouse open.

The shift from auction sales to contracting has been sudden and dramatic. United Tobacco of Wilson, NC, began direct purchases from farmers in 1997, and by 1999, several firms were contracting for specialty tobaccos including Star Scientific and R.J. Reynolds, both of whom were seeking tobacco low in tobacco-specific nitrosamines (TSNAs), a carcinogen whose presence was exacerbated by then-accepted curing methods. Santa Fe, which has since been bought out by R.J. Reynolds, was contracting for organically grown tobacco for its American Spirit cigarettes. One Madison County grower, whose organic burley was particularly low in nitrosamines, told me that he had signed contracts with both Santa Fe and Reynolds in 1999 for $3.20 a pound. This price, which was 70-80% higher than the open market rate, indicates the kind of price advantage that specialty tobaccos can command when in short supply.

Phillip Morris introduced contracts for conventionally grown burley tobacco in 2000, and approximately 28% of the burley crop was sold under contract that year. In 2001, Phillip Morris expanded its contracting program, R.J. Reynolds announced intentions to purchase all of its leaf through contracts, and a host of other buyers including Brown & Williamson, Dimon, Hail & Cotton, and Southwestern jumped on the contracting bandwagon. Although growers specified which form of marketing they would use before the market opened, several redesignation periods allowed them to move between systems during the sales season. When the dust settled, at the close of sales in February 2002, 64% of all burley had sold under contract.

In Allen County, contracting has proven even more popular than elsewhere in the Burley Belt. According to figures supplied by the Farm Service Agency, ninety-nine percent of the 2001 crop, by poundage, was sold through contracts. Why should this area, which is not particularly innovative in other regards, be a leader in adopting contracts? Price is a powerful motive, but the structure of quota ownership and networks for soliciting tobacco also seem to have played a role. Contract prices during the 2001 season ran 3 to 12 cents per pound higher than auction prices for similar grades of tobacco. On average, over all grades, contract prices were 4 cents per pound higher. Since farmers who contract also avoid warehouse commissions and grading fees, they effectively pocket a price that is about 10 cents per pound higher, a price advantage that translates to several hundred dollars per acre.

Lease rates for burley quota have tripled in the past decade as successive quota cuts have reduced the amount of quota within the county. Producers piecing together larger production units by leasing quota are now paying 75 to 80

cents per pound for the production rights. For these growers, who see roughly 40% of the sales price of their tobacco go towards leasing quota, taking the higher contract price is simply the smart economic move. They cannot afford to indulge a nostalgic loyalty to the auction system.

Yet many Allen County growers do not lease quota and sell quite small quantities of tobacco. Their movement towards contracting appears to be explained by very strong networks for soliciting tobacco. One of the contracting companies in the region hired several of the larger, well-respected farmers in the county, paying them on a commission basis, to sign up other farmers for contracts. By selecting opinion leaders scattered in communities throughout the county, the contracting company managed to blanket their coverage and win over most farmers in the county.

Going, Going... Gone?

There is a widespread belief that the traditional system of auction warehouses is on the verge of disappearing. The dramatic reduction in the number of auction warehouses during the past three years lends credence to this idea. Figure 4 shows the number of warehouses that operated in each burley market in 1999 and 2001. An 'X' alone indicates a market that did not open during the 2001-2002 season. Eight out of 47 markets were in that category. (There is one market that does not show on this map—it lies in extreme western Missouri, and it has held steady at 2 warehouses).

In each of the remaining markets, the number of warehouses holding auctions was reduced. Although markets within the Bluegrass region fared well overall, the biggest market, in Lexington, saw a drop from 16 auction houses to 5. A number of markets were reduced to a

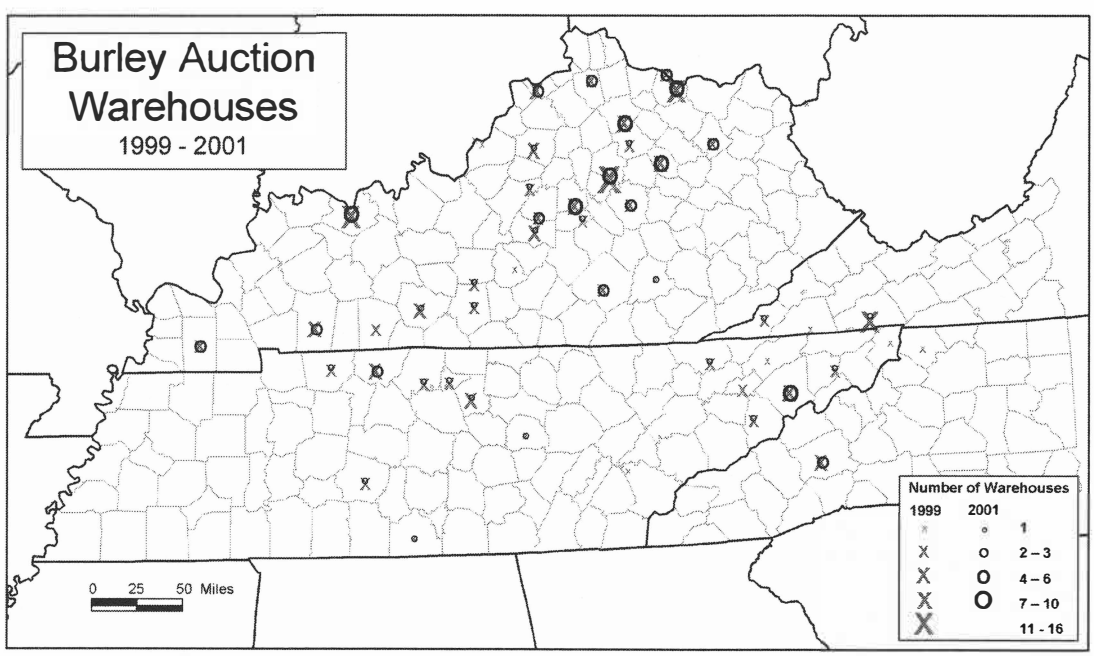

Figure 4. Burley Auction Warehouses, 1999-2001

single warehouse, which leaves them in a tenuous position vis-à-vis future operations. Throughout the Belt, the number of auction warehouses dropped from 164 in 1999 to 77 this season. For areas that have lost markets, growers incur substantially greater transportation costs and inconvenience to market their crop under the provisions of the federal tobacco program. The continued viability of the remaining warehouses is uncertain. The volume of tobacco that they handle has been greatly reduced by the move towards contracting and by quota reductions that have cut the volume of burly available for sale in half since 1997.

The dual marketing system currently offers farmers a safety net in terms of support prices should they not wish to contract. This option is an important protection for small producers who lack the volume of tobacco to command market clout. However, companies offering contracts to date have included many small producers. According to company figures, 48% of the growers who participated in Phillip Morris' pilot contracting program during 2000 had less than 5,000 pounds of quota. But the fear is that, should the auction system disappear, tobacco companies will encourage consolidation of production to streamline their operations by dealing with fewer growers.

The sale of most tobacco via contracts threatens the continued viability of the price support system. The issues here have to do with the effect on the tobacco pool of a dual marketing system, the impact of the loss of grading fees on the federal grading service, and the level that tobacco prices would reach without a price support system. For the tobacco pool, the cooperatives that purchase support price tobacco, the concern is that the auction market will become a repository for lower quality tobacco. Increasing stocks of less desirable leaf raise the costs of operating the pool, costs which are transferred back to the grower under the no-net cost provisions of the tobacco program.

For tobacco to be eligible for price supports, a USDA-certified grader must grade it. Currently, growers selling at auction are assessed a grading fee, but those contracting are not since the contracting companies use their own graders. Should the warehouse system disappear, as things currently stand, there would be no venue or mechanism for implementing the price support system. The danger is that, without the competition of the federally mandated price floor, tobacco companies would significantly lower prices offered in contracts. The USDA, in anticipation of continued contractions of the warehouse system, is holding a referendum in March on mandatory use of federal graders at all tobacco sales, auction or contract. This opens the possibility that the price support system could continue even if the auction system totally disappears.

The dismantling of the price support system and the elimination of tobacco quotas is not unwelcome in all quarters, and in this regard, tobacco producers' interests are divided. Farmers who own quota have a vested interest in the preservation of this economic asset. Farmers who lease in substantial amounts of quota pay annually for production rights and could potentially realize greater profits if production controls were eliminated. As one Allen County farmer put it, "I'd be better off at $1.50 per pound without quota than I am now at $2.00 a pound." Whether that grower would be better off at $1.25 a pound is a more difficult question to answer, and there is no guarantee that a free market price would settle at a point that would allow the grower to realize any of the lease savings. It is also likely that tobacco prices would become more volatile from year to year without the tobacco program.

A final market issue facing warehouse owners and tobacco communities is the adaptive re-use of closed auction barns. Only a few warehouses will be able to convert to receiving stations for contract tobacco. Because of quota reductions in recent years, and the greater efficiency of receiving stations in processing and handling tobacco, many fewer of these are needed. Another group of auction barns will

be converted to other warehouse and storage uses. Discount retailer Dollar General has rented several south central Kentucky warehouses. Lexington's warehouse district has undergone a transformation, as auction warehouses have been torn down, paving the way for redevelopment of prime industrial property, but smaller communities face the possibility that these structures will simply remain empty and unused.

Diversification

Some of the issues facing burley growers are common to farm communities across the country. Diversification is increasingly seen as a strategy for economic robustness. One group in Madison County, Mountain Partners in Agriculture, which was established in 1995 with support from the Kellogg Foundation, has sponsored a variety of programs that promote environmentally and economically sustainable agriculture. The group assisted with the establishment of a tailgate market in the community of Mars Hill, which has provided an opportunity for several of the area's conventional burley farmers to branch out into production of high-value organic vegetables, herbs, and value-added products. They have formed a partnership with an organic producers' cooperative that helps market the produce throughout the Carolinas. Through demonstration projects, workshops, and a community listening project, Mountain Partners in Agriculture is promoting locally supported sustainable agriculture.

Finally, there is a need for these farming communities to celebrate their agricultural heritage. Tobacco festivals, parades, and the crowning of a tobacco queen used to be the centerpiece of community celebrations that focused on the opening of the tobacco market. New ways of recognizing and honoring the agrarian tradition are being sought. A threshing celebration using equipment from the 1920s has been held annually in Madison County since 1988, and the Madison County Plow Day was inaugurated in 1995 by the Grapevine community. These festivals are reminders of agricultural history, but they are also celebrations of the values that remain strong in the community—hard work, neighboring, and living with the rhythm of the seasons. Both are non-commercial events held by and for members of the community. No entrance fee is charged. There are no vendors hawking t-shirts and souvenirs. Conceived, organized, and enacted by local farmers, these events reflect a continuing pride in being part of the American agricultural system, which will help this community weather the transition in tobacco.