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U.S. DEPARTMENT OF AGRICULTURE

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COMMENTS: This is subject matter for Wed. meeting 3-9-94

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MEMORANDUM TO: **DOMESTIC POLICY ADVISOR CAROL RASCO**

FROM: **MARION BERRY**

SUBJECT: **TOBACCO AND EXCISE TAXES ON TOBACCO**

BACKGROUND:

The southeast United States contains many small tobacco farmers that are very dependent on the crop for livelihood. It is the mainstay of the economy in the areas where it is grown.

The tobacco program is self-destructing because of a lack of a provision to control imports coupled with loss of domestic demand. The small farmers are facing a situation that could spell the end of the tobacco program as they have known it. Their most urgent need is to be able to control imports of tobacco in order to maintain domestic market share. The passage of the Uruguay Round by Congress will eliminate almost all possibilities to solve this problem.

These farmers also feel that if a tax is imposed on tobacco products, it will cause the demand to decrease in direct proportion to the tax.

In the budget reconciliation of 1993, there was a provision to limit the content of tobacco products in this country to 25 percent foreign tobacco (Ford Amendment). This was done to make the anticipated tobacco tax more acceptable. This is clearly GATT illegal and will be declared so within 6-8 months. This was agreed to by the tobacco interest in Congress. These same interests must feel a greater sense of urgency about their situation now than they have at any other time.

POSSIBLE ACTIONS TO TAKE:

Do nothing

Do nothing and the tobacco program self-destructs. The disruption of the small tobacco communities results in economic loss and suffering. This problem exists with or without health care reform and an increase in tobacco tax. Implementation of an excise tax will accelerate the rate of decline.

Section XXII

Declare an emergency section 22 to limit importation of tobacco. This will be considered unfair by trading partners. It would be very likely to damage the GATT agreement and the confidence of our trading partners.

Gatt Article XXVIII

There is a GATT consistent way in which imports of tobacco could be limited. Under Article XXVIII of GATT, the United States reserves the right to enter into negotiations at any time. Under this procedure, the United States would replace its tariff only offer with a tariff rate quota as part of its offer of compensatory adjustment. It would have to negotiate with the other WTO members who have Article XXVIII rights. If those members did not accept the United States offer of compensatory adjustment, they would have rights under Article XXVIII to withdraw concessions of their own. Because most countries involved are developing countries, threats of retaliatory withdrawal should not be a problem. The United States should enjoy some leverage in this negotiation.

The negotiations would need to include not only the Uruguay Round offer, but the current tariff binding for the affected tobacco products. Once the agreement is negotiated for the withdrawal of the currently effective tariff binding, there will have to be authority for the President to proclaim a change in the HTS to make the tobacco tariff rate quota effective as soon as possible. This could be accomplished by including that proclamation authority in the Uruguay Round implementing legislation. This proclamation authority could be accompanied in the legislation by repeal of the Ford Amendment, thus replacing GATT inconsistent protection with GATT consistent protection.

There would be a significant advantage in initiating these Article XXVIII negotiations in Geneva immediately and attempting to reach agreement prior to the signing of the Uruguay Round protocol on April 15. Successful conclusion would be very positive for the United States by elimination of the probable international embarrassment from an adverse GATT panel decision on the current Ford Amendment.

Buy-out

This would not be a popular solution with the tobacco interests. The average payments would be $3000 to $4000 for burley quotas and $25,000 to $35,000 for flue-cured quotas.

The average price of $2.50 per pound, with a price-support reduction of 25 percent, would provide a substantial incentive for consolidation of less productive producers.

This scheme would cost about $1.7 billion for direct payments to quota holders. Similar amounts may have to be provided for other claimants. Total cost of $3.5 billion could come from 8 to 10 cents per pack of cigarettes for two years.

Any buy-out plan would be complex. However, it could retire quotas, lower prices, and permit remaining industry to become stronger. It would also compensate those who would suffer because of reduced demand and minimize disruption of the economies in these regions. It would require Congressional action.

Excise tax revenue

Raising the Federal excise tax on a package of cigarettes from $.24 to $1.00 would increase Federal tax revenues about $14 billion annually. Cigarette consumption would decline by 18 percent. An increase in the Federal excise tax from $.24 to $.74 would increase Federal revenues by $10 billion and reduce consumption by 12 percent. The current revenues are $6 billion from this source.

One alternative to this is transferring some of the tax to alcohol and soft drink products. This would make it much more palatable to the tobacco interest.