

## Chapter 5.

### Formal Recommendations: Reports of the Commission's Subcommittees as Adopted by the Full Commission

#### 1. Report and Recommendations of the Commission's Grower Subcommittee: Tobacco Equity Reduction Program

The Commission recommends that Congress establish a Tobacco Equity Reduction Program (TERP) for all U.S. burley and flue-cured\* tobacco quotas to be administered by USDA.

TERP is defined as compensation to burley and flue-cured tobacco quota owners and growers for loss in value of assets that were created in large part because of the current tobacco program. The mandatory quota buyout under TERP would in effect reduce the value of these assets (quotas) to zero. All quota owners would be compensated for their quotas. Quota owners who do not currently grow tobacco would receive compensation and would no longer be involved in ownership of tobacco production rights. Current growers would have the option of receiving production permits. The permits under TERP would be designed to have zero value because they would be assigned annually to growers for production purposes only. The permits could not be leased, rented or sold.

The Commission recommends that compensation for quota owners and growers be based on the average basic quota level for 1997-99 to owners and growers of record in crop year 2000. The 1997-99 base years were chosen because they partially reflect an increase in 1997 quotas that required significant new investments in curing barns and equipment that were essentially rendered valueless after the sharp declines in quota in subsequent years.

**TERP compensation and related issues.** The Commission recommends that compensation for quota be set at three levels — \$8, \$4 and \$2 per pound. All quota owners would be compensated at \$8 per pound. Payments of \$4 per pound would be made to growers for all pounds of quota on which they agree to permanently discontinue production. Growers would receive \$2 per pound for all pounds of quota on which they wish to continue production. The \$2-per-pound payment is essential to provide current growers an opportunity to continue producing tobacco. Many are heavily in debt for barns and equipment that now are only being partially used and many, especially renters, do not have sufficient funds to purchase the

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\* Grower associations representing minor kinds of tobacco (*all kinds of tobacco produced under a tobacco control program other than burley or flue-cured tobacco*) told the Commission that they are in favor of a quota compensation program, transferring quotas into the hands of active growers, and a system that would keep price supports in place. However, they noted that there are significant differences in the cigarette tobaccos and the minor kinds of tobacco and said that they have not formulated a program that will satisfy the needs of all concerned growers of the minor kinds of tobacco.

Note also that a separate state program has been established for Maryland tobacco, a kind of tobacco not under a marketing quota control program. Current Maryland tobacco growers can receive payments of \$1 per pound per year for up to 10 years in exchange for permanently discontinuing tobacco production.

materials needed to grow tobacco. Without this payment, U.S. tobacco production could well drop sharply, with production shifting overseas where pesticide and other health controls are inferior to those in the United States.

The Commission recommends that compensation be paid over five years through a non-revocable contract between the federal government and quota owners and growers. Special consideration should be given to small quota owners (*owners of farms having 1,000 pounds or less basic quota*) who are retiring from tobacco production by allowing these owners to receive their full TERP payment in the first year of the program. This special compensation provision, as well as all TERP compensation, should be provided through the Commodity Credit Corporation (CCC) and repaid by revenues from an increased federal excise tax on all packs of cigarettes sold in the United States. The total cost of TERP is likely to be between \$15 and \$17 billion, requiring a federal excise tax increase of about 17 cents per pack of cigarettes. The revenues from the increased excise tax should be placed in a self-liquidating trust fund in the U.S. Treasury and used to repay the CCC for TERP compensation and to fund additional recommendations described in this chapter for economic development assistance and health proposals.

Compensation for quota should not be restricted to any payment limitation since the asset (*quota and related farming assets*) value has been declining over several years. Payments for some U.S. agricultural programs are restricted to various limits such as for crop year 2000 in the production flexibility program (*\$40,000 per producer per year [a seven-year program]*), market gains on commodity loans and loan deficiency payments (*\$75,000 per producer per year [raised to \$150,000 for 1999 and 2000]*) and the annual disaster program (*\$80,000 per producer per year*). The TERP compensation would be a one-time payment reflecting a loss in asset value over time — not a recurring payment such as those just mentioned.

The Commission recommends that various investment strategies be incorporated into the payments to quota owners and growers to lessen the impact of taxes on these receipts. The strategies could include use of the funds for 401K-type retirement plans (in essence, quotas are currently being used as a retirement plan because they provide a stream of annual income for the owner through payments from leasing or renting the quota). Other strategies include tax incentives for reinvestment of TERP funds in community enterprises and allowing capital gains treatment of TERP funds for income tax purposes.

**Modification to the current tobacco program under TERP.** The Commission recommends continuation of a federal tobacco price-support and production-control program. Under TERP, the Agricultural Adjustment Act of 1938 and the Agricultural Act of 1949 (*permanent legislation*) would be modified as follows:

- Production permits would be substituted for quotas. Production permits would be issued to active growers (*individuals or entities*) only. Permits would be issued for the purpose of growing tobacco only, and they could not be sold, leased, rented or transferred. Following are the principle elements of the proposed permit system.

- Growers will be considered active growers if they are (1) 100 percent “at risk” in the crop and (2) actively engaged in the production of the crop. To be considered actively engaged in the production of tobacco, the grower must provide:
  - (a) a significant contribution of one or a combination of capital, land (*rented or owned*) and equipment, and
  - (b) a significant contribution of one or a combination of active personal labor or active personal management.

For partnerships, the members would have to provide the contributions to be considered actively engaged. Active personal labor is defined as personally providing physical activities necessary in the farming operation. These activities include land preparation, planting, cultivating, harvesting and marketing the crop. USDA’s Farm Service Agency (FSA) county committees would be empowered to determine 100 percent “at risk” and “actively engaged” determinations. (*Proof of active grower status would be based on invoices, including evidence of payments such as bank statements and canceled checks, for labor, pesticides, other chemicals, fertilizer, equipment, fuel, repairs and tobacco sales bills; operating loan documentation or other sources of operating capital and related management decisions; or other proof acceptable to the FSA committee that the grower is 100 percent at risk in the tobacco crop.*) For corporations, the corporation would have to be actively engaged.

- Initial production permits would be established for growers based on the prior year’s effective quota for which the grower was at risk in the crop. A quota owner who currently shares in the risk of production by growing tobacco on shares with a tenant could receive a permit for that share of the crop for which they are at risk. (*As an example, under a one-third rental arrangement, the owner could get a permit for a one-third share of the production unit assuming the owner takes the \$2 compensation option. Once the permit is issued, the owner would have to become an active grower and be 100 percent at risk in the crop and remain so to retain the permit. The owner could not establish another tenant/landlord relationship. The tenant in this example would get a permit for two-thirds of the production unit, assuming the \$2 option is chosen. The tenant would have to become an active grower and be 100 percent at risk in the crop to retain the permit.*)
- Permits would be issued to and in the name of active growers with one permit per active grower per county. Permits would be assigned to active growers for production purposes only and would have no tie to real estate.
- Permits would be considered fully utilized if at least 75 percent of the permit is marketed, but no under-marketing credit would be allowed. Any permit not utilized would be subject to permanent forfeiture. FSA county committees would be authorized to make determinations on permit forfeitures within specified parameters such as conditions beyond the control of the active grower that kept the permit poundage from being produced and marketed.

- The pounds from forfeited production permits would return to a county pool for redistribution within the county. Any permit pounds not redistributed in the county would revert to a state pool for pro-rata distribution to all active growers within the state. Any permit pounds in a state pool not redistributed within the current crop year would be dropped and redistributed to other tobacco-growing states.
- Heirs (*surviving spouse or direct descendants*) or direct descendants of a retiring active grower would be allowed to assume the permit of an active grower and establish a new active grower status. FSA county committees would make these determinations. In a partnership, a permit could be issued to a direct descendent in the same manner as with an individual grower. If certain members of the partnership leave no heirs, their portion of the permit would be forfeited. In a corporation, permits would continue as long as the corporation continued as an active tobacco grower.
- All tobacco buyers would be required to submit accurate purchase intentions. If 100 percent of the intentions were not purchased (*if production were available*), buyers would be subject to the same marketing penalty (*75 percent of the previous year's average market price for the respective kind of tobacco*) as producers for program violations on each pound not purchased.
- The Commission recommends no change from the current formula in calculating price-support levels. But we do recommend that if requested by the board of directors of a tobacco loan association (*through which price support for the respective kind of tobacco is made available to growers*), USDA may reduce the support level for such kind of tobacco to the extent requested by the association to more accurately reflect the market value and improve the marketability of such tobacco. Any reduction in price supports under this provision shall not be used to establish subsequent year price-support levels.
- All tobacco transfer provisions, including spring lease and transfer, purchase and sale and disaster transfers, would be eliminated because permits would be issued annually for production purposes only.
- Only one marketing card would be issued for each active grower per county regardless of the number of farms on which tobacco is planted. The active grower would need to report the farms on which the tobacco is planted under the permit for compliance purposes only.
- Current over-marketing provisions (*limited to three percent of the effective quota and deducted from subsequent quotas*) would be continued.

- To handle carryover tobacco (*tobacco produced in excess of the farm's quota and carried over until the next crop year for marketing*), the Commission recommends that growers who choose the \$4 per pound option to retire from producing tobacco and who have carryover tobacco can either
  - destroy the tobacco (*supervised by FSA*) and receive the full payment or
  - receive reduced compensation by an amount equal to the carryover poundage times the national price-support level for the kind of tobacco for the year produced and take a one-year temporary permit to market the carryover tobacco. Temporary permit poundage would be deducted from the national permit poundage for the subsequent crop year.
- The Commission recommends continuation of new-grower and inequity adjustment provisions. Currently, new-grower provisions include experience growing the crop for two out of the preceding five years; having land, labor and equipment available for production; and expecting to receive at least 50 percent of income from farming, excluding the requested quota. We recommend that the income requirement be dropped and that a national reserve of three percent be withheld to approve new-grower permits and make inequity adjustments. We also recommend that all reserve poundage not used for new-grower permits be used to make inequity adjustments. A minimum of 8,000 permit pounds should be allocated to a new flue-cured grower and 4,000 pounds to a new grower of burley. These levels would be needed to provide a marginally economical production unit (*for example, about 8,000 pounds of tobacco is needed to fully utilize one flue-cured tobacco curing barn*). Smaller amounts of burley can be grown because there is greater size flexibility in the construction of curing barns. The minimum levels would be initial allocations under the new-grower provision. However, to the extent additional permit poundage becomes available, the growers could request additional permit pounds to increase the income and efficiency of their operations.
- With the emergence of contracting, we recommend an auction warehouse designation program for all kinds of tobacco. Growers would be required to designate the number of pounds to be sold at auction and at which warehouse(s) and the pounds to be sold at non-auction.
- We recommend that all imported tobacco be subject to the same no-net-cost assessments as are domestically produced kinds of tobacco. (*Currently, flue-cured and burley imports are the only tobaccos subject to such assessments.*)
- Production permits should be issued to active growers for use within a specific county. However, if the producer owns or rents land in a contiguous county, the permit could be moved to that county even if the county lies in another state.
- The allotment control provision for flue-cured tobacco should be continued, but yields should be adjusted to reflect more current yield-per-acre levels for active growers.

- Current reduction and penalty provisions should be continued, including false identification, scheme and devise to defeat the purpose of the program (*including falsification of active grower status*), failure to return marketing cards, etc.
- Current eminent domain provisions should be continued. (*Displaced landowners have three years to acquire new farmland on which to reestablish their operations.*)
- Tobacco Marketing Quota Review Committees should be eliminated. All tobacco program appeals should be handled through the FSA Administrative Appeals process.
- Production permits should not be subject to Conservation Reserve Program reductions. (*Currently, tobacco allotments and quotas are reduced by the same percentage as cropland accepted in the CRP is of the total cropland in the farm.*)

The above recommended changes to the tobacco price-support and production-control program should add stability for active growers because production right costs (*rental/lease costs*) would be eliminated. Other suggested program changes would more accurately match supply and demand by increasing penalties for failure of manufacturers to meet purchase intentions, reducing production speculation and providing greater certainty and stability in tobacco marketing. These changes would insure continued production of tobacco in current production areas, continue to provide opportunities for new growers and provide more equitable treatment of active tobacco growers.

The Commission also recommends:

- That a viable auction-marketing system be maintained to keep domestically grown tobacco competitive on the foreign market and provide a safety net for non-contract tobacco growers. The Commission recommends that tobacco loan associations be permitted to establish receiving stations in a production area when it is determined that active growers in this area do not have ready access to traditional auction markets. Tobacco buyers should be provided an opportunity to purchase any tobacco delivered to these receiving stations before the tobacco is pledged for a price-support loan. The Commission recognizes that it will be a challenge to keep the price-support program intact as more and more tobacco is sold through contracts.
- That all tobacco be graded and inspected by USDA, whether sold at auction or directly to buyers through contracts or other means.
- That all imported tobacco should meet the same pesticide regulations as U.S.-grown tobacco. Currently, USDA's Agricultural Marketing Service tests for the presence of certain pesticides on imported flue-cured and burley tobacco. These imports account for approximately 50 percent of all imported tobacco. Chemical testing should be broadened to include chemicals currently banned and those not approved for use on tobacco in the United States.

**TERP and related funding issues.** TERP funding must be reliable and guaranteed. There are a number of potential sources, but some have no assurance of continuation or are not consistent with the guiding principles the Commission adopted. Consequently, we recommend that the increase in the federal excise tax described earlier be used to fund TERP.

We recommend an increase in excise taxes despite the fact that Phase II payments from the agreement between cigarette manufacturers and tobacco producers could be reduced. The losses of Phase II monies would be more than offset by the certainty of funding directed to quota compensation and a shift to lower-cost production of U.S. tobacco.

Funding is also needed for other activities related to the tobacco program to assure measurement and monitoring of tobacco production and consumption in the United States and abroad and to provide U.S. tobacco growers greater opportunities to participate in the world tobacco market. The Commission recommends adequate funding to:

- Support USDA's Foreign Agricultural Service in the collection and dissemination of information regarding production, consumption and related tobacco-industry information from around the world.
- Support and enhance the tobacco data collection and dissemination functions of USDA's Economic Research Service.
- Support the existing prohibition against any U.S. government efforts to increase smoking overseas or to promote the sale of U.S. brands in foreign countries as necessary to the protection of public health. Government efforts to remove unfair trade barriers to the sale of U.S. tobacco leaf overseas could be done without creating any risk of increasing smoking levels or harming the public health. Allowing U.S. leaf to compete fairly with its competition overseas will neither increase foreign smoking levels nor make cigarettes more harmful. Accordingly, U.S. export and import policies and practices concerning tobacco leaf should be consistent. For example, Brazil has 53 percent or 176.5 million pounds of the current Tariff Rate Quota for tobacco imports, but annually imports only 1.5 million pounds of U.S.-produced tobacco; Malawi has eight percent or 26.6 million pounds of the Tariff Rate Quota and imports only a small amount of U.S.-produced tobacco. However, in addition to trade policy, other factors influence tobacco trade between countries.

**Tobacco Grower Advisory Board.** Establish a Tobacco Grower Advisory Board and require USDA, EPA, FDA, the U.S. Trade Representative's Office and related federal departments and agencies issuing rules and regulations governing tobacco production and product control to notify this Board prior to initiation of any rule-making process to provide the Board an opportunity for timely input. The Board's purpose would be to advise the federal departments and agencies on the economic and technical feasibility of proposed actions.

The Commission recommends that the Board be established as part of the Center for Tobacco-Dependent Communities (*see next section of this chapter*). The Board should be comprised of burley and flue-cured tobacco growers and appointed by the Board of Directors of the Center.

## 2. Report and Recommendations of the Commission's Economic Development Subcommittee: Center for Tobacco-Dependent Communities

**Background.** Tobacco farming is broadly distributed across 568 counties, mostly in the southeastern United States. Tobacco is grown in most counties of Kentucky, North Carolina and Tennessee. It is an important part of both the economic and social fabric of communities in parts of other states, including southern Virginia; the coastal plain of South Carolina, Georgia and Florida; and southern Indiana, Ohio and Maryland. The largest flows of tobacco income are in the counties of the coastal plain of North Carolina, where farm tobacco sales generally run between \$20 million and \$50 million per year — in addition to significant income from stemming and redrying operations. Tobacco sales average between \$1 million and \$9 million in most other tobacco-growing counties.

The Commission recognizes that some communities are more vulnerable to declining tobacco production and income. Traditionally, economists estimate the economic vulnerability to reductions in tobacco production by determining the share of a county's total income derived from tobacco farming. Using the tobacco income to personal income ratio, USDA's Economic Research Service concluded that 80 to 214 counties may be particularly vulnerable. Of the 568 tobacco-growing counties, 28 had tobacco income to personal income ratios exceeding 10 percent, 52 counties had ratios of 5 percent to 10 percent and 135 counties had ratios between 1 percent and 5 percent. The remaining 353 counties had ratios under 1 percent. Using just this measure, 80 counties can be identified that are particularly dependent on tobacco and potentially the most vulnerable to declining tobacco receipts. The 135 counties with a ratio of 1 and 5 percent may also be vulnerable, depending on the stability of other local economic activity.

Other analyses have examined proximity to metro areas as an indicator of vulnerability to the decline in tobacco income. Such analyses find counties in or adjacent to growing metropolitan areas — whether small cities such as Danville, Virginia, or Rocky Mount, Greenville and Goldsboro, North Carolina, or larger cities such as Lexington and Louisville, Kentucky or Knoxville, Tennessee — account for 73 percent of estimated tobacco receipts. Proximity to population centers usually means more immediate opportunities for non-farm jobs, rising land values and a ready customer base for non-tobacco farm products such as fruits, vegetables, pick-your-own and other on-farm business ventures. In a sense, proximity to metro economies often means that these communities are less dependent on tobacco income. However, a large number of the 568 tobacco counties (193 counties, or 34 percent of the total) are not adjacent to any metro area. Though these counties account for only about one-fifth of tobacco receipts, the tobacco farmers who live there and their communities face greater challenges in finding non-tobacco income and are therefore more dependent on tobacco and vulnerable to changes in the tobacco-growing industry.

More analysis of county-level economic conditions is needed to gain critical information on the actual vulnerability of a county to reductions in tobacco-related activities and to help identify those most in need of economic development assistance. It is especially important to identify the full range of economic links in a county's economy that are directly attributable to various tobacco-related activities,

including the so-called “multiplier,” or secondary, economic effects that can measure the extent to which other businesses rely on the circulation of tobacco receipts. Also significant are the degree to which the tobacco industry is vertically integrated in a community, the degree to which a county’s economic base is diversified and the extent to which a county is dependent on other declining sectors. Broad measures of long-term economic distress such as relatively high poverty and unemployment rates are general indicators of local economic vitality that should be considered in any vulnerability analysis.

### ***What Does the Commission Mean by Economic Development?***

***Economic development is where public policy, including expenditures of funds, intersects with the private sector for the purpose of promoting the creation of jobs, income and wealth. There has always been a public sector role in economic development — from early federal funding of infrastructure such as canals, roads and railroad subsidies and the creation of the first publicly funded and very successful technology transfer system (land grant colleges and the agricultural extension system) to national investments in space and military research and development. State and local investments focused on industrial recruitment at first and then expanded to include services that strengthen existing businesses and promote new small businesses and entrepreneurship.***

**Resources and Gaps.** Existing federal and state programs for economic and community development can provide substantial resources to help transitioning tobacco-producing communities develop new on-farm and off-farm enterprises. Programs range from grant and loan funds for water and sewer and other industrial infrastructure to technical assistance grants for small-crop agriculture and development of small businesses. Communities may avail themselves of such resources and can seek assistance from their state and local economic and agricultural development offices for help with program requirements and application procedures.

Additionally, a unique opportunity for tobacco-dependent communities may be the financial assistance available from the Master Settlement Agreement,\* at least in those states that are making a share of their settlement funds available for economic development.

A major gap is the inability of small communities, not well practiced in the intricacies of economic development and diversification, to access available assistance and funds. While both states and communities list planning and readiness as critical to the formulation of proposals that will have long-term impacts, many tobacco-dependent communities do not have the resources to do the initial planning.

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\* National legislative proposals prior to the Master Settlement Agreements included significant funds for economic development assistance to tobacco-growing communities. For example, the LEAF Act provided \$8.3 billion solely for economic development activities over 25 years. In lieu of a legislative solution, the state attorneys general reached a national settlement agreement with cigarette manufacturers.

Furthermore, they often lack the expertise to identify the most advantageous economic development opportunities for their communities to pursue. And for those farmers that want to develop non-tobacco crops, the technical assistance is hard to find to make the most of supplemental crops or other business alternatives. In some cases, both tobacco farmers and their communities lack the funds and expertise necessary for start-up businesses in tobacco-growing and non-tobacco enterprises.

The needs and problems of tobacco-dependent communities are diverse. And they will not all be solved with financial assistance. Some farmers want to remain in farming but need to shift their primary emphasis from tobacco to other crops. Other tobacco farmers may want to explore non-farm business ventures. Workers whose livelihoods depend on tobacco warehouses or stemming and redrying operations may have few transferable skills and need retraining. The community businesses that support tobacco growers and other tobacco-related workers and rely on tobacco income for their livelihoods are faced with the need to change business or perish. Making funds available for economic development is simply not sufficient to help communities and individuals with such diverse needs.

While the tobacco-growing states have substantial financial resources at hand to support community revitalization, few — if any — are set up to provide the programmatic support that tobacco-dependent communities and farmers need to make the successful transition from a single-crop agricultural economy to a thriving, more diversified economy. Therefore, the Commission does not propose substantial additional financial resources for economic development. Rather, we believe the challenge is to identify existing resources, use them efficiently and effectively to develop strong in-community capability and infrastructure and create a learning network among tobacco-dependent communities.

**Recommendation: Center for Tobacco-Dependent Communities.** An inextricable link exists between the well being of tobacco farmers and their communities. That link is clearly recognized in the name of this Center. Based on the Commission’s findings, research, and testimony from farmers, community leaders, and policy makers, the Commission recommends the creation of a regional center that will work closely with tobacco growing communities to stem the decline due to changes in the tobacco growing sector and help farmers and communities transition to more diversified and resilient local economies.

The Commission recommends that Congress create a regional center to assist communities in making the transition from tobacco-based economies. The proposed legislation should:

- Authorize the establishment of a non-profit corporation — the Center for Tobacco-Dependent Communities — that is not an agency or other entity of the United States government.

- Authorize a seven-member Board of Directors for the Center, six of whom shall be appointed by the President and confirmed by the Senate, with no more than three members from one political party. The seventh member will be the Center’s Executive Director, to be appointed by the Board.
  - Board members shall be eminent in rural development issues — especially small-crop agriculture, entrepreneurship, and industrial, small business and community development — and shall have experience and knowledge appropriate to the responsibilities of the Center.
  - Board members will serve staggered four-year terms, with three members serving an initial two-year term and three members serving an initial four-year term.
- Authorize funding for the Center at \$5 million annually for at least 10 years through revenues from the Commission’s proposed 17-cent increase in the federal excise tax on every pack of cigarettes sold in this country (*see Chapter 4*).
- Authorize the Center to receive, in addition to public funds, private bequeaths, donations and foundation and other grants.
- Direct the members of the initial Board to serve as incorporators and authorize them to take whatever actions are necessary to establish the Center for Tobacco-Dependent Communities.
- Direct the Center to serve the 568 tobacco-producing counties identified by USDA’s Economic Research Service, with particular focus on counties that the Center determines are the most dependent on tobacco for revenue.
- Establish that the purpose and objective of the Center is to be an active agent of economic and community development assistance for communities to transition from tobacco-based economies. The emphasis of the Center will be on agricultural development — including sustainable and other small farm agriculture, and alternative uses of tobacco that do not harm the public health — and entrepreneurship, and will specifically provide outreach and education activities to farmers and small communities with limited capacity to access current resources. In keeping with this purpose, the Center shall:
  - Provide communities and farmers with targeted technical assistance.
  - Convene meetings and conduct workshops and conferences.
  - Act as a clearinghouse for best practices.
  - Provide research and policy development.
  - Advocate for communities transitioning from tobacco-based economies.
  - Provide up to \$1 million each year for grant-making activities such as challenge grants, community mini-grants, technical assistance grants and pilot demonstrations.

In order to leverage federal economic and business development program funds (*grants and loans*) and create an interagency awareness of and commitment to transitioning tobacco-based economies at the federal level, the Commission recommends that the President create a federal interagency working group at the assistant secretary level. This interagency effort, including USDA, the U.S. Department of Health and Human Services and U.S. Department of Commerce and other agencies as appropriate, will be responsible for coordinating and targeting federal economic and business development program funds (*grants and loans*) for tobacco-dependent communities. The working group should take advantage of input from and consultation with the Center for Tobacco-Dependent Communities.

In conjunction with recommendations under TERP (*see first section of this chapter*), the Commission recommends creating market incentives for tobacco farmers, quota holders and others receiving Phase II and other compensation or indemnification payments. The purpose is to encourage use of those funds as capital for new business ventures, on-farm or off-farm, that have the potential to create new economic activity and community revenues in tobacco-dependent communities. The incentive should be market based; for example, preferential tax treatment if the funds are invested within a certain amount of time for business activities.

### 3. Report and Recommendations of the Commission's Health Subcommittee: Public Health Proposals

**Recommendation: Support state tobacco prevention and cessation efforts and other health programs.** The Commission recommends that states do more to fund comprehensive tobacco prevention and cessation programs such as those suggested in the August 2000 Report of the Surgeon General to reduce tobacco use and the harms caused by tobacco. Therefore, the Commission recommends that once TERP has been fully funded, revenues from the increased federal excise tax recommended by the Commission (*see Chapter 4*) be used for a period of five years to provide states an incentive to adopt state programs to reduce the consumption of tobacco products as well as other state public health programs.

States that have allocated state funds for tobacco prevention and cessation programs at levels that meet or exceed the minimum standards (adjusted for inflation) set by CDC would be eligible for funding to enhance their tobacco prevention and cessation efforts or, if they choose, to fund other state public health initiatives. States that have previously failed to fund tobacco prevention and cessation efforts at the level recommended by CDC would become eligible for grants that could be used for other public health purposes only when they have raised the level of state funding for tobacco prevention and cessation programs to at least the minimum level recommended by CDC.

Funding would be administered by CDC through cooperative agreements between CDC and appropriate state health agencies.

**Recommendation: Regulate tobacco products.** The Commission has concluded that manufactured tobacco products should be regulated. We recommend that FDA be given effective authority to establish fair and equitable regulatory mechanisms over the manufacture, sale, marketing, distribution and labeling of tobacco products with the USDA and EPA retaining authority to set safety standards governing tobacco farms and tobacco production. This authority should be comparable to FDA's authority over other products. It is not the intention of this Commission or public health advocates in granting the FDA such authority to legally prohibit the use of tobacco products by adults.

This action would fill the gap created by the Supreme Court's decision that the FDA does not have authority over manufactured tobacco products. The Supreme Court explicitly said that it is up to Congress to provide FDA with this authority. This proposal would establish the authority of the FDA to regulate tobacco products.

The Commission recognizes that there is much that can be done that is not now being done to prevent marketing to and the use of tobacco by young people, encourage and assist adults who wish to quit to do so, require full disclosure of ingredients, harmful constituents and other facts the FDA considers likely to protect the public health, prevent misleading labeling and claims, provide independent evaluation of the relative harmfulness of different products and their ingredients and constituents, and reduce the harmfulness of tobacco products sold to consumers.

In the long run effective regulation by the FDA benefits everyone, including farmers. It will save lives. Independent science based decisions by FDA designed to

protect the public health by taking all reasonable steps to reduce the harm of tobacco products now being sold and promote the introduction of less harmful products will also create fair standards and will provide predictability to farmers and to the industry. Farmers may benefit directly. This Commission believes that America's tobacco farmers are better able and better equipped to respond to actions designed to address the health concerns posed by current tobacco products. This proposal will provide an opportunity for America's farmers as well as responsible manufacturers to distinguish themselves from their foreign competitors in producing crops in an environment in which health concerns are important. Because FDA's rules provide farmers an opportunity to be heard before any rule is finally adopted, it will also prevent farmers from having to change what they are doing on short notice at the arbitrary whim of individual manufacturers who demand new production techniques or leaf characteristics based on corporate decisions with no public or farmer input.

FDA authority would be designed to protect the public health and reduce tobacco caused harms, but not prohibit tobacco use. To ensure that the FDA remains focused on the protection of public health and the reduction of harm rather than prohibition, the Commission recommends that the standard that the FDA use to guide its decision making be the "protection of public health" rather than the standard it applies to other products, that is, whether there is a "reasonable assurance that a product is safe and effective." Tobacco products as they exist today are not "safe." Given the number of Americans who use tobacco products today, prohibition would not protect the public health because it would drive many smokers to use unregulated black market products. Therefore, a statutory standard designed to promote the "public health" rather than one that requires that a tobacco product be "safe" best protects everyone's interests. It also recognizes that the status quo for current products is not in anyone's interest if it is possible to reduce the harm that tobacco products cause.

There has been substantial debate about whether tobacco products should be treated as "drugs." This is not a debate about whether nicotine in tobacco products is addictive because there is agreement that it is. Many farmers are concerned about a legislative action that labels tobacco products as "drugs." Public health organizations are concerned that the FDA be given the type of authority needed to effectively address the health issues raised by nicotine and tobacco products. Therefore, notwithstanding the Commission's recognition that nicotine in tobacco products acts as a drug, to obtain the support of both the representatives of the farm community and the public health community, the Commission's emphasis has been on what constitutes effective regulation, which can include its treatment under a separate chapter which does not regulate it as a "drug" for statutory purposes.

The Commission also recommends that USDA and EPA retain authority to set safety standards governing tobacco farms. Thus, the Commission's proposal would not extend FDA authority to farming operations. Under this proposal FDA will not have authority over tobacco farms but farmers will be able to have input into important decisions through FDA's normal rulemaking process.

Consistent with these goals and principles and the Core Principles adopted by farmers and health groups in 1998, the Commission recommends that FDA be provided with authority consistent with the following guidelines:

***Access and marketing.*** FDA should have authority regarding the sale and distribution of tobacco products, including access by young people. It should also have authority concerning tobacco advertising and promotion with a particular emphasis on marketing that appeals to young people and marketing and labeling claims, campaigns and images in order to prevent the public from being deceived or misled.

***Adoption of youth access and marketing restrictions of the 1996 rule to help reduce youth tobacco use.*** To avoid the unnecessary waste of taxpayer resources and bring about quicker results, the legislation should incorporate the substance of the youth access and youth marketing rules set out on pages 44615 through 44618 of Vol. 61 Federal Register dated August 28, 1996 and adopted by the FDA so that the agency will not need to go through a new rulemaking process to implement them. This will bring both speed and certainty to the process.

***Health information disclosure.*** FDA should be entitled to receive all documents and information in the tobacco industry's possession relating to health effects of all tobacco products, nicotine and its effects on the body, addiction, marketing to children and its effects, and such other information that the HHS Secretary deems necessary to enable the FDA to protect the public health.

***"Public health" standard.*** The existing FDA standard for approving drugs and devices is whether there is a "reasonable assurance that a product is safe and effective." Because there is no such thing as a safe cigarette, the proposal adopts a "protection of the public health" standard for all tobacco products that refers to reducing health risks to the American public. This provides protection for those concerned about a "ban" that FDA won't just "ban" tobacco products because they are not "safe." For those concerned that FDA have adequate authority to reduce the number of people harmed by tobacco products, including existing tobacco products, this standard keeps the focus on health.

To be certain that FDA keep its eye on the big picture, this standard should require that in deciding what promotes the public health, consideration should be given to the overall impact of a proposal on public health when considering the population as a whole. This includes a broad range of factors, such as whether a product change or new rule will reduce or increase tobacco use or alter the type of products used and whether it will likely increase the number of new users or decrease the number who quit.

**Health warnings and labeling.** FDA should have authority over health warnings on tobacco product packages and advertisements, including the power to revise and add health warnings and to alter their format, including, but not limited to changing their size, location, and color. Four years ago as part of their 1997 negotiations with the state attorneys general the tobacco industry agreed to a revised set of warnings and a new warning format that were consistent with the warning system then in effect in Canada. These warnings and format should be included in the legislation to avoid an initial long and costly rulemaking process.

**Disclosure of ingredients.** FDA should have the authority to require the tobacco industry to provide a complete list of all tobacco ingredients and additives, by brand and by quantity, and the authority to require that this information be given to the public in a manner that does not disclose legitimate trade secrets. It should provide FDA with authority to regulate the use of any ingredient or additive that is harmful or which contributes to the harmfulness of the product. As is the case for the manufacturers of all other products, the burden should be on tobacco manufacturers to demonstrate that each ingredient and additive is not hazardous in the quantity used under the conditions of intended use. The issue should not be whether the ingredient makes the product more harmful than existing products; it should be whether the ingredient causes harm. The goal is not to maintain the status quo; it is to reduce the number of people injured.

**Authority to reduce or eliminate harmful components.** The technology already exists to remove many of the components of manufactured tobacco products that are known to cause harm. FDA should have the authority to evaluate scientifically and then through notice and comment rulemaking, the standard process, to decide whether to reduce or, where appropriate, eliminate the harmful and/or addictive components of manufactured tobacco products in order to protect the public health. This process will give farmers, public health representatives, manufacturers, consumers and other stakeholders an opportunity to bring to the attention of the agency the impact of any specific proposal on their particular needs and concerns. This authority should not be limited to ingredients added by the tobacco manufacturer where the technology exists to reduce or eliminate a harmful constituent of the product or its smoke. This authority should focus on health considerations and not seek to reduce tobacco use by requiring the addition of an ingredient simply because it negatively impacts on the product's taste.

A benefit for farmers, responsible manufacturers and public health representatives of this authority residing in the FDA is that FDA's rules provide for input from any interested party and organization and require FDA to review and take into consideration the comments it receives. FDA's rules also provide protection against arbitrary and capricious action. The creation of the Tobacco Grower Advisory Board will further ensure that farmer concerns are aired and considered prior to the rule-making process. Thus FDA authority provides predictability and an opportunity for farmers, the public health community and others to be heard when the FDA is considering the adoption of a rule setting a safety standard for manufactured tobacco products that farmers believe may impact them. It specifically means that farmers will have an opportunity to bring the impact of any proposed

action on America's tobacco farmers to the attention of the agency prior to the adoption of such a rule and that obligations imposed by the agency to reduce harm will be imposed only after careful consideration of all relevant factors brought to the agency's attention, including those raised by farmers.

**Health claims and "reduced risk" products.** FDA should have the authority over products that purport to reduce consumer health risks or serve as less harmful alternatives and the authority to evaluate scientifically whether these products are actually "less harmful" taking into consideration both individual consumers and the population as a whole. FDA's authority should prohibit or restrict directly or indirectly:

- (1) unsubstantiated health claims and
- (2) false or misleading claims.

**No FDA authority over tobacco farms or tobacco growers.** The legislation should recognize that it is USDA and not the FDA that has authority over tobacco farms or tobacco growing.

**Recommendation: Include tobacco-cessation in basic Medicaid and Medicare coverage.** As the nation's largest health care purchaser, the federal government has a vital role to play in promoting effective, affordable smoking-cessation services that will assist those tobacco users who want to stop. Research consistently shows that smoking cessation saves lives and reduces smoking-related health care costs and is one of the most cost-effective health interventions available. Neither Medicare nor Medicaid provides reimbursement for some of the most effective smoking-cessation treatments recommended by the Department of Health and Human Services' Clinical Practice Guideline for treating smoking cessation.

We recommend that funding for smoking cessation be included in basic Medicaid and Medicare coverage. One goal is to help lower-income people stop smoking or consuming other tobacco products. And Medicaid coverage is an especially effective way to reduce smoking among young pregnant women and new mothers, thereby avoiding smoking-caused health care costs for the mothers and their babies.

Studies indicate that comprehensive cessation assistance through Medicaid will reduce overall state health care costs and state Medicaid costs. At least 24 states have elected to provide some form of tobacco-cessation assistance through their Medicaid programs.

Medicaid should provide both prescription and non-prescription smoking-cessation drugs for its beneficiaries. Current Medicaid law allows states to exclude FDA-approved smoking cessation therapies from coverage, and fewer than half of all states provide coverage for smoking-cessation products in their Medicaid programs. Given that 57 percent of all Medicaid recipients are current or former smokers, Medicaid should provide full coverage for smoking cessation.

We estimate the cost of the coverage to be about \$25 million per year for Medicaid and about \$75 million per year for Medicare and recommend that these costs be funded from the revenues received from our recommended increase in the federal excise tax on cigarettes sold in this country. This funding would become available after the five-year period for compensating tobacco quota owners and growers has ended.