

Kentucky tobacco farmers provide model for deregulation, increased production and profit

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If someone agreed to buy your home as is a year from now, you'd likely cancel the kitchen remodel. According to a study at the University of Illinois, Kentucky tobacco farmers adopted that same logic when the tobacco companies announced the buyout – also known as the Tobacco Transition Act of 2004 that ended a 66-year-old federal farm program. However, the immediate drop in productivity was followed by startling changes. Over the 10-year period of the study, the number of farms declined from just over 40,000 farms to just over 8,500 farms – but productivity increased by 44 percent.

"The quota system limited the amount of tobacco that could be grown," U of I agricultural economist Barrett Kirwan said. "By reducing the supply, farmers were guaranteed their price but it also guaranteed that less productive farms would keep producing because they'd see a price that was higher than what they should have been getting. As soon as that was removed, the less productive farms couldn't survive. There was a massive reallocation and massive shift of production to more productive farms. Those farms weren't realizing their full production potential."

After the buyout, the total acreage farming tobacco in Kentucky declined, but the remaining acres became more productive. They began producing more tobacco per acre on fewer acres. The acreage also relocated to the western part of the state where the soil is more suitable.

"The farmers who stayed began growing specialty tobacco used for cigars or chewing tobacco," Kirwan said. "The niche markets for

tobacco haven't been hit as hard as the main cigarette market so without the quota system, restrictions were lifted. Farmers no longer had to grow only burley tobacco; they could diversify in chewing tobacco or cigar tobacco, which are specialty, higher-value tobaccos."

The study found that the most productive farmers were also the most diversified with crops other than just tobacco.

"They didn't have a decline in productivity leading up to the buyout," Kirwan said. "Their tobacco production did not decline, and after the buyout their tobacco productivity rose dramatically and so did their acreage. Their acreage more than doubled."

According to Kirwan, the diversified farms already had equipment, such as drying barns to cure the tobacco. After the quotas were lifted, they could capture the economies of scale.

"A drying barn is the same size whether you're drying a little tobacco or a lot of tobacco, so lifting the quantities allowed them to actually fill the drying barn and become much more efficient," Kirwan said. "Because they already had the invested capital, it became much more profitable for them to stay in tobacco and get bigger than it would have been to switch to a different crop."

Farmers were also able to save due to input reallocations, such as being able to shift fertilizer and electricity and workers.

"You get this double kick from removing the quota," Kirwan said. "When the quota was removed, it allowed resources to move, giving an 8.3 percent increase, but the removal of the quota itself gave 22 percent. That's a total of a 30 percent increase just by removing this regulation."

Kirwan said the findings from the study can be analogous to other

commodity programs.

"In agriculture, there have been these types of farm programs for about 80 years and there is some variance, but this was one of the few times that we could see an absolute end to a program with no hope of coming back.

"Other programs may not be as binding as the tobacco program with quota limits, but when we're distorting the market price with subsidies or we're distorting a farmer's production choices by saying, 'If you grow vegetables, then you no longer get subsidies for your corn,' then we're distorting their productivity," Kirwan said.

He noted that the study focused on productivity, not equity. So although the farms were much more productive, it did put many small farmers out of business. He said the findings could help guide policy makers who are deciding whether or not to change quota or subsidy programs.

"They have to weigh this potentially huge efficiency gain with the consequences on the equality side – possibly creating fewer small farms. Which is more important? Having a lot of small farms or fewer, more productive farms?

"There are anecdotes that subsidies prop up inefficient farmers who shouldn't be farming anyway, but they are just that, anecdotes," Kirwan said. "By doing this study, we could see just how much more productive the new [tobacco](#) farmers were. We looked at the demographic differences in these two groups and confirmed that these new, more productive [farmers](#) are young."

More information: "Aggregate and Farm-level Productivity Growth in Tobacco; Before and After the Quota Buyout" was published in the *American Journal of Agriculture Economics*.

Provided by University of Illinois at Urbana-Champaign

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