Peanut Policy

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Background

The 1996 Farm Bill amended previous legislation to continue the peanut program of supply control and price supports through the 2002 crop. The program is a result of several modifications by previous farm bills designed to meet changing supply/demand conditions and to minimize government cost. Three regional grower associations established in 1937, which act as marketing agents for the Commodity Credit Corporation, administer the loan provisions. Handling, processing, and quality control is coordinated by the Peanut Administrative Committee under USDA Marketing Agreement 146 (1965).

Before the 1996 Farm Bill, peanuts were protected from imports by Section 22 of the Agricultural Adjustment Act of 1933. Changes in U.S. trade policy eliminated Section 22 protection for peanuts. NAFTA (North American Free Trade Agreement) was approved in 1993 and GATT (General Agreement on Trade and Tariffs, now the WTO) was approved in 1994. These agreements eliminated Section 22 and established declining tariff schedules and minimum import access levels to the domestic market.

NAFTA is a free trade agreement with Mexico. The tariff rate for peanuts becomes zero in 2008. At the current quota support price of $610 per ton, the tariff schedule will become ineffective in keeping Mexican peanuts out of the U.S. by 2005. Declining tariffs and minimum access make it increasingly difficult and costly to control domestic supply.

The major provisions of the current peanut program are:

- Supply is controlled through poundage quotas set annually by the Secretary of Agriculture at a level to meet U.S. edible and related uses.

- The 1996 Farm Bill provided temporary seed quota to all producers that is allocated each year based upon the amount of acres planted.

- The 1996 Farm Bill eliminated "undermarketings." Nonproduced quota (undermarketing) is no longer allowed to be carried forward to future years. If a farmer is unable to produce their quota due to weather and other uncontrollable factors, the producer is allowed to fall transfer the nonproduced quota. A producer can do a disaster transfer of segregation 2s and 3s peanuts up to 25 percent of the farm's quota at 75 percent of the quota support price.

- Peanut production above the farm's poundage quota is referred to as "additionals.". These peanuts are produced and sold primarily in the export and crush markets. Some additionals may also enter the U.S. edible market through the "buyback" provision or CCC. Farms without peanut quota may also grow additionals.

- Price support is provided through a two-tiered price system. Quota peanuts are supported at a fixed rate of $610 per ton (down from $678 in 1995) for the life of the 1996 Farm Bill. The support price for additionals is set by the Secretary to ensure that the CCC incurs no losses in the additionals pool. The 2001 support price is $132/ton for additionals.

- Quota may be sold or leased within the same county. Under the 1996 Farm Bill, a limited amount of quota may be sold or leased across county lines within the state. Spring sale and lease is allowed in-state and capped at 40 percent of the county base quota level as of January 1, 1996. Fall transfer is unlimited within the state.

- Quota will be reduced if not produced or "considered produced" in two of the three previous years.

- The 1990 Budget Act initiated a marketing assessment beginning with the 1991 crop. Currently, the producer share is 0.65 percent, while the first handler share is .55 percent.

- Peanuts are a "no-net cost" program to the government under the 1996 Farm Bill. Producers face increased assessments in the years following program losses. Regulations on minimum resale prices and cross-compliance between the regional associations minimizes government cost exposure.

Current Situation and Forces of Change

Quality

Peanuts, when sold by the producer, are in-shell and referred to as "farmers stock." Peanuts, upon inspection, are segregated into three categories reflecting quality. In-shell peanuts are inspected visually for *A. flavus* mold, which indicates aflatoxin contamination. Peanuts with no mold and less than 2 percent damage are placed in Segregation 1 and may be marketed for quota (domestic edible) or edible export use. Peanuts with no mold but greater than 2 percent damage are placed in Segregation 2. Peanuts with visual *A. flavus* are placed in Segregation 3 and crushed for oil and meal. In an average year, a small percentage of the crop (3-5 percent or less) will be graded Segregation 2 and 3. Drought years can see the percentage increase significantly.

CCC Loan Activities and Cost

Most peanuts are contracted or sold by the producer directly to a handler. There is no quota contract deadline, but additionals must be contracted by September 15 or placed in CCC loan. Quota may be contracted, priced, and sold at delivery or placed in CCC loan.

Imports of Peanut Paste and Confectionaries

Imports of peanut butter/paste have been increasing. These imports have mostly originated from Canada (about 75 percent during the 2000 calendar year), Mexico (13 percent), and Argentina (9 percent). Peanut butter imports from Mexico increased by 300 percent in 2000.

Mexican peanut butter can enter the U.S. without any tariffs or quotas. Peanut candy, cookies, and confectionary items are not included in the NAFTA or GATT/WTO agreements. Thus, an estimated 175,000 tons of farmer stock equivalent peanuts are

entering the domestic market each year unrecognized by the trade agreements. Peanut processing/ manufacturing is slowly moving offshore to take advantage of these exceptions. Once the infrastructure is in place, it becomes difficult to recapture manufacturing capacity.

FTAA

GATT/WTO and NAFTA agreements can be likened to an approaching tidal wave. A potentially larger tidal wave is looming offshore in terms of another trade agreement. FTAA (Free Trade Area of Americas) proposes to cover the entire Western Hemisphere from Canada to the tip of Chile. The agreement has a target date of 2005 for completion, and it moves toward more free trade. Major export competitors, Argentina and Nicaragua, would be included under the agreement with potentially similar minimum access and tariff schedules as Mexico has under NAFTA. FTAA could encourage Brazil (the largest peanut producer in Latin America before it's switch to soybeans), to become a major player again.

Issues

The peanut program has survived several farm bills and has been modified over the years to improve supply/demand balance, become more market-oriented, and reduce government cost exposure. However, the industry is at crossroad that will determine the future of peanut production in the U.S. Major issues facing the program would include:

- **Stagnant quota demand.** USDA has estimated quota needs at 1.18 million tons for the last three crop years — 1999, 2000, and 2001. Domestic use has steadily increased over this time period, but quota has not subsequently increased.

- **Divided industry.** Recent history has seen producer groups at odds with other segments of the industry — largely shellers and manufacturers. Regional grower groups differ on the direction of the peanut program. Given the political environment against supply control programs, a united front is necessary to maintain a viable program.

- **Buybacks.** Excessive use of buybacks led to an oversupply of quota in 1999, creating heavy losses in the CCC loan pool. Buybacks are helpful in making up shortfalls in quota. If overused, however, they can create losses by displacing quota. Shellers and producers must regulate themselves to avoid overuse.

- **No-net cost.** The no net cost provision requires producers to pay for any CCC losses incurred by the program. Approximately a third of the $71 million CCC loss from 1999 remains to be paid. Marketing assessments through 2002 will go to paying off the debt. The possibility of another CCC loss exists as domestic buyers may cut back purchases in anticipation of lower prices under a new farm bill.

- **Trade Agreements.** Trade policy and the peanut program are currently at odds. The reduction of trade barriers has made it increasingly difficult to control supply. Imports undermine quota levels when the price support is higher than the world market.

- **Aflatoxin testing.** Visual inspection for *A. flavus* still leads to cost for the industry. Peanuts graded Segregation 1 visually may, after chemical testing, contain above the allowed level of aflatoxin and have to be crushed. Conversely, Segregation 3 peanuts may contain acceptable levels of aflatoxin.

- **Yields and technology.** Yield increases have not been significant since the 1970s. Adoption of newer varieties and approval of new chemicals could result in higher yields in the near future and reduce cost per ton. Loss of chemicals due to environmental or food safety regulations could impact the three peanut-producing regions differently.

- **Green weight purchase of peanuts.** Shellers want to use new technologies in the purchase and

handling of farmer stock peanuts, which means a change in the current grading and marketing system. This would also allow shellers to reduce the cost of handling peanuts. Producers do not want to change.

Policy Alternatives and Consequences

A consensus agreement among producers and industry concerning the peanut program is hard to find. Peanut production regions and industry segments differ on what they want and on what the program should be.

To keep the current system as it is, quota price support will likely have to be lowered. Many are opposed to lowering the price support — especially given the price environment for the overall agricultural economy. Several modifications and alternatives are being explored to enhance the program in light of the current political and economic environment.

Modifying the Existing Program

- **Eliminate the no-net cost provision.** No-net cost was implemented in the 1996 Farm Bill to limit government cost and losses. Given a budget surplus heading into the crafting of a new farm bill, producers could look for relief from current and potential CCC losses.

- **Provide quality incentives and disincentives.** To encourage production of high quality, aflatoxin free peanuts, adjustments could be made in the support price structure. Producers could receive a higher price for peanuts meeting specified quality standards, or receive a discount for poorer quality.

- **Adjust the marketing system for additional peanuts.** For those who want to produce additional peanuts, several modifications may improve the conditions for marketing them. Allowing the CCC to sell additionals for edible export at world prices instead of the minimum resale price would increase market orientation.

  Another modification would allow additionals to be purchased for government food programs. This would reduce quota demand but reduce government cost for food programs.

- **Price support and reimplementing a price escalator.** Producers support raising the quota support price to reflect higher costs of production, and returning to a price escalator capped at two to three percent annually. To be more competitive with imports, however, the price support would have to be lowered from $610 per ton. The higher the support price, the greater the windfall gains by importers under minimum access and declining tariffs.

- **Step-2 type payment.** To make quota peanuts more competitive, a cotton Step-2 type provision could be adopted. Buyers and processors would be allowed to purchase domestic peanuts at a price competitive with imports. Producers would receive a higher price similar to the current price support. The government would cover the difference between the support price and buyer price. The difference could be paid directly to the buyers, as is similarly done with cotton, or payments could go directly to producers by moving peanuts through the area associations.

Potential Alternatives

- **Federal marketing order.** Peanuts could be converted to a federal marketing order program similar to milk or fruits and vegetables. Producers would receive income support based upon certain quality standards.

- **Buyout.** To transition from a quota allocation program, the government could buy out the quota to compensate quota holders for the amounts accumulated through production and investment over the years. Peanut production could expand, move, or concentrate in areas with a competitive advantage. Elimination of quota without

compensation would cause financial distress for many producers.

- **Marketing loan for all peanuts.** A non-recourse-marketing loan could be established for peanuts — similar to other program crops such as cotton, corn, and wheat. The marketing loan price would provide downside price protection. Peanuts could be placed into the loan to give producers more flexibility in marketing their peanuts. An alternative to putting peanuts in the loan would be to sell the peanuts and request a loan deficiency payment on those peanuts if prices are below the loan rate.

- **AMTA payments for peanuts.** Included with a marketing loan would be the establishment of decoupled fixed payments for peanuts. The marketing loan rate would be significantly below the current domestic support price of $610 per ton. Thus, the decoupled payment would allow for peanut producers to adjust to a new program over time. These payments would be similar to the AMTA payments established under the 1996 Farm Bill. AMTAs are considered a non-trade-distorting subsidy fitting in the "green box" category of the WTO trade agreement.

- **"Green payments" for keeping rotations.** Peanuts are often grown in rotation with other non-legume crops such as cotton and corn. For optimal yields and quality, rotations of three to five years between peanut crops are recommended. To preserve the quality of U.S. grown peanuts and to encourage long-run environmental stewardship, green (conservation) payments could be made available to peanut producers for maintaining or incorporating rotation practices with peanuts.

- **Counter-cyclical payment.** Marketing loans provide a safety net but are limited to what was produced. Two or three years of loan rate prices are not economically sustainable. Counter-cyclical payments could be established to provide additional support only in years of historically depressed prices and yields. Payments would trigger when an index falls below the target level. Income or value of production has been suggested as an index. The target could be created on a national level or regional level.

No Program

Peanut income contributes to a significant portion of total farm income in many locations. In some rural communities, agriculture and peanuts specifically constitute the major economic base and infrastructure.

In the absence of a price support and quota program, farm prices for peanuts would decrease. Quota would have no value. It is difficult to estimate the price level under the absence of a program. Some geographical shifts would occur as production adjusts to its highest comparative advantage. Lower prices resulting in reduced income and land values, as well as locational shifts, would cause financial distress among farmers and economic difficulty in many southern rural areas.

The processing end of the peanut industry is an oligopoly. The effects of lower farmer prices would not likely be passed on to the retail level. If full savings were passed on, the amount would be small.

Conclusion

Peanuts are an economically important crop in many southern rural areas. The major factors presently impacting the industry include GATT/WTO and NAFTA market access and tariff rates, imports of peanut butter, and uncertain U.S. consumer demand. These and other forces will likely need to be considered in any program modification. The present program seems to be headed on a collision course with imports. Changes likely have to be made in domestic or trade policy for the U.S. peanut industry to remain viable. Changing trade policy seems to be a remote chance at best. Modifications or changes in the peanut program will likely come with an increased cost to the government.

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