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PEANUT PROGRAM

Impact on Peanut Producers, Users, and the Government

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to participate in your hearing on the Peanut Title of the 1995 Farm Bill. This program supports peanut prices and controls peanut supplies through a system of production controls--only producers having government quota may sell in the domestic market--and import restrictions. Our testimony is based primarily on our 1993 report on the U.S. peanut program.[1] The objectives of our report were to (1) discuss changes that have occurred in peanut farming since the program was created in the 1930s, (2) assess the impact of the program on producers, peanut buyers, the government, and international trade, and (3) identify needed changes in the program.

In summary, our 1993 report stated that the peanut program has generally stabilized the U.S. peanut supply while supporting producers' income. However, peanut farming, like other U.S. agricultural operations, has undergone substantial changes since the 1930s. Most importantly, the number of peanut farms and producers has decreased and the size of the remaining farms has increased. By 1991, fewer than 22 percent of all peanut producers held over 80 percent of the available government quota. Therefore, the benefits of this program are concentrated among a relatively small percentage of quota peanut producers. Moreover, since 1982, the annual peanut quota support price established by the U.S. Department of Agriculture (USDA) has provided quota peanut producers, on average, revenues that are (1) about 51 percent above USDA's estimate of average production costs[2], and (2) about 26 percent above total economic cost of production.[3] Furthermore, owners of more than one-half of the quota pounds do not actually grow peanuts themselves but instead receive income from selling or renting their quota to others.

From 1982 through 1989, the world market price for U.S. peanuts averaged $494 per ton and the U.S. quota support price for domestic peanuts averaged $714 per ton.[4] Consequently, economic

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[1] Peanut Program: Changes Are Needed to Make the Program Responsive to Market Forces (GAO/RCED-93-18, Feb. 8, 1993).

[2] Production costs are the costs used by USDA to determine the quota support price. They include variable and fixed cash expenses plus profit allocations for capital equipment replacement and unpaid labor. They do not include the cost of land or the amount that producers pay to acquire quota.

[3] Total economic costs include the costs of production discussed above plus the cost of land.

[4] These figures, as well as others discussed in this testimony, are in 1991 dollars.

studies show that U.S. peanut buyers are spending hundreds of millions of dollars more each year for peanuts with the program than they would spend without the program. In addition, USDA spends tens of millions of dollars each year to administer the peanut program, make mandatory payments to producers, and cover the extra cost of the peanut products that it buys under various food assistance programs. Lastly, the program may affect international trade, primarily by influencing the volume of U.S. peanuts available for export, however the magnitude of the program's effect is unclear.

In view of the many changes that have occurred in agriculture since the peanut program was created--including the globalization of agricultural markets, the reduction in the number of peanut producers receiving most of the program's benefits, and the increases in costs to U.S. peanut buyers--we recommended in our 1993 report that the Congress restructure the peanut program to make it more responsive to market forces. As part of this restructuring, we recommended, among other things, that the Congress (1) reduce the annual quota support price to more closely parallel the cost of producing peanuts and the world market price and (2) amend the peanut legislation to allow the quota support price to decrease as well as increase each year as production costs decrease and increase.

BACKGROUND

Chaotic economic conditions during the Great Depression led the Congress in 1934 to institute the peanut program to control the domestic supply of peanuts and protect producers' incomes. Although the program has been amended several times, it currently controls the domestic supply through a national poundage quota system and import restrictions. Each year USDA sets the national poundage quota so that the amount of peanuts produced is about equal to estimated domestic use. Then USDA assigns a portion of the national poundage quota to eligible farms. In 1953, import restrictions were introduced into the peanut program as a mechanism for protecting U.S. producers from foreign competition. As a result, we reported in our 1993 report that imports accounted for less than one-tenth of 1 percent of the annual national poundage quota. However, according to recent information from USDA, the Uruguay Round agreements of the General Agreement on Tariffs and Trade and the North American Free Trade Agreement will likely increase the amount of imported peanuts entering the U.S.

Generally, only producers holding a portion of the assigned quota may sell their peanuts domestically (as quota peanuts), while producers without quota must export theirs (as "additional" peanuts). The program protects producers' incomes through a two-tier system that sets minimum support prices for quota and additional peanuts. In 1995, the quota support price is $678 per ton and the additional support price is $132 per ton. Producers may sell their peanuts directly on the market at or above these support prices, or they may place their peanuts under loan with USDA and have the government sell them. Also, because quota is transferrable, the peanut program can provide income to those quota owners who decide to sell or rent their quota to others. USDA's Consolidated Farm Service Agency administers the peanut program; the Commodity Credit Corporation (CCC) provides funds to producers who place their peanuts under loan rather than sell them directly on the market.

PEANUT FARMING HAS CHANGED SUBSTANTIALLY OVER TIME

Peanut farming, like other U.S. agricultural operations, has become increasingly concentrated as smaller farms have been consolidated to form larger-scale operations. The number of peanut farms with quota has decreased--from 172,981 in 1950 (the earliest data available) to 41,249 in 1991--as the average farm size has increased, from 12 acres to over 49 acres. Furthermore, through technological advances and other improvements, such as increased applications of fertilizer, improved techniques for irrigation, and the development of new varieties of seed, peanut farms now produce yields nearly five times greater than the yields produced in 1934.

THE BENEFITS OF THIS PROGRAM ARE CONCENTRATED AMONG QUOTA PEANUT PRODUCERS

In our report, we stated that in 1991, 6,182 producers--or fewer than 22 percent of the 28,867 U.S. peanut producers--controlled over 80 percent of the quota. From 1982 through 1992, the annual quota support price averaged $697 per ton, while USDA's estimated cost of producing peanuts averaged $463 per ton--a difference of $234 per ton. Because of the quota support price level, quota producer revenues average about 51 percent above USDA's estimate of production costs and about 26 percent above total economic costs. We should point out, however, that these estimates on revenues above production and total economic costs cannot necessarily be equated to actual profits to producers. To determine profits, we would have to know the actual prices at which peanuts were sold and the actual costs incurred by producers.

Because the quota support price is required to increase each year when production costs go up but not to decrease when costs go down, the gap between prices and costs has generally increased over time. The peanut program also provides payments (known as disaster transfer payments) to protect quota producers from losses in peanut quality caused by adverse conditions. Also, "additional" peanut producers receive dividends when their peanuts are sold for more than the "additional" support price. In our 1993 report, we stated that producers received on average about $11 million a year for disaster transfer payments and about $64.5 million a year in dividend payments.

The peanut program also benefits persons who own farms with assigned quota but elect not to grow peanuts with that quota because the program allows these persons to sell or rent their quota to others. In Georgia, the state with the largest percentage share of the national quota, we estimated that sales of quota totalled about $2.3 million in 1990. As for rentals, in 1988, 68 percent of all quota owners nationwide, who held 56 percent of the available quota, rented their quota to others. On the basis of that rental level, we estimated that peanut producers could have paid $208 million in 1991 for the privilege of using someone else's quota.[5] Although quota sales and rentals provide income to quota owners who do not produce peanuts, their quota can not be sold or rented outside county boundaries. Thus, it limits competition because peanut producers in other counties who may be more efficient cannot buy or rent that quota.

THE PEANUT PROGRAM COSTS U.S. PEANUT BUYERS HUNDREDS OF MILLIONS OF DOLLARS EACH YEAR

Under the peanut program, producers' incomes are supported primarily through transfers, that is, a "tax" that peanut buyers pay to producers in the form of higher market prices for peanuts. Economic studies and our analysis estimate that the peanut program adds, on average, anywhere from $314 million to $513 million each year to U.S. peanut buyers' costs to buy peanuts. About 76 percent to 88 percent of these costs are transferred directly to producers as income, and the remaining portion represents a welfare loss to society that reflects inefficiencies in the program's use or allocation of resources. We should point out that peanut buyers' costs are measured on a so-called farmers' stock basis: In other words, they represent the costs to the first buyers of U.S. peanuts. We did not determine the extent to which these costs are passed on to the ultimate consumers of the finished peanut products.

USDA SPENDS MILLIONS OF DOLLARS YEARLY TO OPERATE THE PEANUT PROGRAM

The federal government's (i.e., USDA's) peanut program cost was substantially reduced by legislative changes in 1977 and 1981, which transferred most of the program's cost to U.S. peanut buyers. Nevertheless, from 1986 through 1990, USDA still incurred average costs of about $34.4 million a year: $14.5 million to cover CCC loan losses, $4.5 million for program administration, $11.0 million

[5]According to officials from USDA and the peanut industry, quota rentals in 1991 ranged from 10 cents to 14 cents a pound. On the basis of these varying figures, we estimated that a reasonable quota rental rate in 1991 would have been 12 cents a pound. Our estimate assumes that all of the quota was rented at the same price, regardless of the rental arrangement.

for disaster transfer payments, and $4.4 million to help producers and exporters develop foreign markets for peanuts. Although CCC loan losses average $14.5 million during this period, CCC loan losses were $95 million in 1991 and USDA estimates losses may be as high as $100 million in 1994.

In addition to these direct program costs, the agency incurs higher costs in its food assistance programs because it must buy peanuts at the quota support price rather than at the lower world market price.

THE PEANUT PROGRAM MAY ALSO AFFECT INTERNATIONAL TRADE

In our 1993 report, we stated that in 1990, the United States exported 474 million pounds of peanuts valued at approximately $103 million (in 1991 dollars), and that the United States was the world's leading exporter in 7 out of 10 years from 1981 through 1990. Because we are a leading exporter, the peanut program may affect world trade by influencing the volume of U.S. peanuts available for sale on the international market. The magnitude of the program's effect, however, is unclear because there is uncertainty as to the extent that (1) the program results in additional U.S. exports, (2) the volume U.S. peanuts sold as exports affects world prices, and (3) producers would respond to price changes on the world market if the peanut program did not exist.

RECOMMENDED CHANGES TO THE PEANUT PROGRAM

The chaotic agricultural and economic conditions that caused the Congress to establish the peanut program over 60 years ago no longer exist. Most peanuts in the United States today are produced by larger-scale operations rather than by the small family farms that dominated agriculture in the 1930s. For these and other reasons, we concluded in our February 1993 report, that it was time to take a closer look at determining how the peanut program could be made more responsive to market forces.

To this end, we recommended that Congress (1) reduce the annual quota support price so that, over time, the price will more closely parallel the cost of producing peanuts and the world market price; (2) reexamine the method of assigning quota since a large volume of quota is owned by persons who do not grow peanuts with that quota; (3) allow the quota support price to decrease as well as increase each year as do production costs; (4) permit government agencies to purchase peanuts at the world market price rather than at the higher quota support price.

In implementing this program restructuring, we recommended that the Congress provide for a period of transition to allow producers time to make adjustments in their investment decisions.

In determining the length of any transition period, we said the Congress, with assistance from USDA, should consider producers' investments as far as (1) the producers' expectations concerning the life of the peanut program and (2) the useful life of capital investments in equipment specifically purchased for peanut production.

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Mr. Chairman, this completes my prepared statement. I would be pleased to answer any questions that you or Members of the Subcommittee may have.

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