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PRICE SUPPORT AND SUPPLY MANAGEMENT POLICY FOR PEANUTS

Bill R. Miller

The current peanut program provides an example of supply and price management that may hold potential for future policy initiatives for other commodities. Post World War II policies, focused on price and income support for agriculture, were based on inelastic markets — with relatively small supply reductions postulated to substantially increase prices to farmers. Approaches to supply control include 1) Restricted output by acreage allotments or marketing quotas, 2) retirement of entire farms through a soil bank program and 3) farmers may also be directed to divert land in order to participate in some price enhancement programs. Any current use of these approaches must also address the need for international trade expansion, minimization of government costs, and the potential for non-competitive price structures. These are important issues in the construction of policy and all are related to the peanut program.

COMPETITIVE STRUCTURE IN PEANUT MARKETS

Biggs, et al, reported that first-buyers of peanuts in North Carolina and Virginia purchased 85 percent of their volume of peanuts within 10 miles of the buying station in 1962. Hubbard and Fletcher reported essentially the same pattern for Georgia in 1977. Since 1949, first stage marketing was characterized as immediate delivery of peanuts at harvest to local buyers at announced support prices. However, adverse weather changed the complexion of the first stage marketing process in 1980, and the Farm Bill of 1981 calls for more change. The 1980 drought reduced production to about 58 percent of normal levels. However, most farmers sold peanuts at near the quota loan rate as storage was not available on farms or in commercial warehouses. But late in the season, some farmers received twice the support price.

A special compilation of compliance data from the Federal inspection and grading system reveals there was only one buyer at 60 percent of all country buying points in the U.S. (Table 1). Moreover, about half of the U.S. peanut crop is purchased at these stations in normal years. Most of the buying points are operated on a commission basis by agents of peanut shellers. Individual shellers controlled as many as 40 buying points in a production region. Fifty one shellers were identified in 1977 as purchasing 97 percent of the commercial crop — excluding commodity credit corporation purchases. Although the U.S. Department of Agriculture identified 115 first handlers of peanuts in 1979, it is clear that a small volume of peanuts was purchased by the 64 handlers who are non-shellers (Table 2).

The top four shellers in all major production

states, except Georgia, purchased 80 percent or more of the total peanuts sold by farmers (Table 3). Georgia had the largest number of handlers with the top four firms purchasing only 60 percent of farmers stock peanuts. High concentrations also exist in peanut processing. Four-firm ratios — percentage accounted for by 4 largest firms — were estimated for the major domestic uses of peanuts: 1) Peanut butter 53%, 2) salted peanuts 54%, 3) peanut candy 66%, and 4) peanut butter sandwiches 92%.

The ratios show only the amount of product produced by the top four plants in each sector. Also, these ratios understate the concentration of firms in all types of processing as there were firms with plants in two or more of the major types of processing. Although in this summary it was not possible to determine if a firm owned plants in more than one type of processing, it is general knowledge that this is the case. Thus, the top four firms in the U.S. who manufacture the major peanut products control more than 53 percent of total output.

There is no hard evidence that current concentration ratios result in peanut prices below competitive market levels. However, the fact that farmers gained very little pricewise in 1980 from a sharp reduction in supply and the high concentration ratios in all market channels portend a weak competitive structure. Thus, government constraints may be needed to offset market power on the buyer side which farmers cannot counteract.

THE EXPORT MARKET FOR USA PEANUTS

U.S. production of peanuts was 10 percent of world production in 1979, but the U.S. has a disproportionately large share of the world edible market. Fresh peanut quality is highly perishable and requires facilities for drying, cleaning, shelling and storage (including climate control). Without these facilities there is loss of color and flavor accompanied by product deterioration. Availability of these facilities explain why the U.S. supplied 59 percent of the world edible commercial market in 1979. The U.S. accounted for 318,100 of 540,000 metric tons of edible peanuts imported by Canada, Western Europe and Japan.

The U.S. share of the world edible market had been increasing since 1978. Subsequent to 1978, a two-price plan for peanuts was included in the 1977 Food and Agriculture Act. The act provided a new concept of poundage-quota. Poundage-quota was a volume of peanuts supported at a price higher than former levels for edible peanuts used in the domestic market. Under programs prior to 1977, all peanuts were produced under acreage allotments and supported at the same price level. The one-price

policy apparently restricted U.S. exports prior to 1978. The 1977 Act set quotas at about 80 percent of former acreage allotment production. The remaining or additional 20 percent of allotment production for years prior to 1978 was supported at a lower level in the 1977 Act. "Additional" are intended to be sold at free market prices for export as edible nuts. This goal was reached in 1978 and 1979 in that most "additional" were exported at favorable prices. The average price of "additional" peanuts was \$389 per ton in 1979 compared to a support level for "additional" of about \$220 and \$455 for quota peanuts. More recently prices for additional have been depressed by a large inventory. Domestic consumption and exports decreased as a result of the short-fall in production in 1980, and neither have regained the pre-1980 level.

During the first crop year, 1977-78, following volume quotas, exports increased from 783 million to 1,025 million pounds (farmers' stock basis) and remained at about the same level in 1978-79 and 1979-80. The improvement in the terms of trade for U.S. peanuts followed many years of U.S. production priced above world market levels. Thus, there appeared to be potential to relax supply control and take advantage of the world demand for quality nuts at attractive price levels. A production cost study in Georgia, indicated that good farmers using irrigation, could produce runner peanuts for \$350 per ton (1979 Mackert et al).

PROVISIONS OF THE 1981 LEGISLATION

The Food and Agriculture Act of 1981 retained the two-price plan and volume quotas but abolished peanut acreage allotments permitting the unlimited production of "additional" peanuts for export at world market prices. The 1981 act also permitted new producers to enter the market and thus eliminated the cost of renting allotment to grow additional peanuts. This resulted in a substantial cost reduction as average allotment rentals were in the range of \$125/ton in Georgia in 1979.

Domestic market quota and "additional" — not purchased by domestic or world markets — are purchased at support prices — quota or "additional" loan level — by the Commodity Credit Corporation (CCC). CCC can resell quota peanuts at prices equal to or higher than CCC cost (quota loan redemptions). The remaining option for CCC is sale for crushing. "Additional" peanuts may also be resold on a competitive bid basis — additional loan redemptions — and are generally restricted to export sales or crushing. However, under a special buy-back provision, "additional" peanuts can enter the domestic edible market.

The peanuts for edible domestic market are not restricted to the domestic quota. Preceding as well as current policy allowed buyers to Buyback "additional" peanuts for domestic use. However, this option must be exercised within 24 hours of delivery and at the edible quota support price or greater. The buyback of "additional" (92 million pounds) was relatively minor in 1979 (Table 4), but could increase in the future with increasing domestic market demand. Buyback under the 1977 program allowed buyers to take the "cream of the crop" from the additional supply, but forced CCC to purchase an equivalent amount of high support-price quota of

lower quality that moved into CCC crush, thereby increasing taxpayer cost. A new approach to setting volume quota in the 1981 Farm Bill drastically changed the motivation for purchasing buybacks. For example, if the 1983 quota is set below the quantity demanded in the domestic market at support price this will cause domestic users to bid for buyback "additional" to fill domestic demand. If bidding is competitive for the best quality peanuts, this might push 1983 market price in the U.S. above support price. With 1983 quota below domestic demand at the support price, there is no CCC crush of excess quota and little price support cost to taxpayers.

Data for 1979 should be used for setting 1983 domestic edible quota as this was the last normal year before the 1980 drouth and the 1981 legislation. Major disappearance of production in 1979 consisted of commercial quota purchased by first buyers (2,805 million pounds), quota loan redemption (483 million pounds), and a CCC crush of 428 million pounds in the U.S. (Table 4). Contract "additional" (483 million pounds), and additional loan redemption (150 million pounds) were exported. Based on the level of CCC crush, the 1979 quota of 2,805 million pounds exceeded domestic edible demand at the 1979 price support, and is verified by consumption estimates. Prior to 1979, inventories of peanut products were largely pipe-line stocks with annual production of peanut products about equal to consumption. Domestic consumption was estimated at about 2,530 million pounds in 1979 and provides guidelines in setting 1983 quota, (Table 5). Should 1983 quota be set at this level or lower, then price supports at current level would minimize government cost. The quota level adopted in the 1981 Bill was 2,400 million pounds — or slightly less than 1978-80 domestic consumption. Should the domestic market be less than 2,400 million pounds in 1982 then quota should be further reduced. Holding support price level and reducing quota could allow the buyback provision to operate and satisfy domestic demand at the level of price support. However, the period for buyback purchases should be greatly expanded to allow the mechanism to work. Operation of an extended buyback policy should strengthen the market for "additional" which was depressed in 1982.

POLICY IMPLICATIONS

The level of price support for poundage-quota will remain controversial. The 1981 Bill set the price at \$550 per ton for average grade and quality. Perhaps the best guide for new price support will be CCC purchases. Large CCC purchases of poundage-quota would reveal that the support price is too high to clear the market and quota should be lowered for the next year. Farmers should support efforts to fine tune both support prices and quota that minimize CCC purchases. This would reduce government cost — a primary goal of the current administration. Cost of production is not germane to continuing the current program, but it continues to be addressed by many farm leaders since price must cover all costs in the long-run. A policy issue not adequately addressed is that of a system of price discovery and market structure that will achieve this farm price goal. If farm price supports were abandoned, would prices offered by shellers and processors drop below a level that would yield a

competitive return on all farm resources? Given the 1983 level of depressed farm prices, this is a serious question that must be answered.

The price discovery process for "additional" peanuts appears to be disorganized in that there is no apparent bid and offer procedure to establish farm price. In fact, contracts for "additional" are now being linked to contracts for quota even though at present there is no clear relationship between price level in the quota and "additional" markets. Since farmers have very little on-farm or other available storage, many feel that they have no alternative than to accept what is offered by a local buyer. Many appear to believe there is no profitable loan and resale of additional by CCC at greater than loan price although this has been an alternative in the past.

The policy debate assumes that agriculture and agribusiness are competitive industries. High concentration ratios in shelling and processing imply that this may not be the case. Until the case of workable competition is proven and farm prices are at an acceptable level, the current peanut policy provides safeguards at low government cost with increased freedom of entry and the opportunity for export expansion. Export expansion is a necessity for substantial growth in the peanut sector. The peanut program may even serve as a model for other commodities now under price pressure. An obvious need is to organize a competitive market for "additional" via forward contracts and a commodity futures contract in shelled peanuts.

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Table 1. Number of Buyers and Peanuts Purchased at One-, Two-, Three-, Four-, and Five-Buyer Buying Points in the U.S., 1979-80 Crop Year.^a

Buyers	Buying Points		Peanuts Purchased ^a	
	Number ^b	%	Mil. lbs.	%
1	300	60	1,606	48
2	131	26	1,017	31
3	53	11	490	15
4	14	3	129	4
5	6	1	77	2
Total	504	101 ^c	3,319	100

^aFarmers' Stock basis.

^bNumber buyers per buying point. One buying point had 7 buyers.

^cMay not add to 100 due to rounding.

Source: Summarized by the author from USDA files.

Table 2. Purchases of Farmers' Stock Peanuts by Shellers and Unidentified First Handlers, By Type of Peanuts Purchased 1979-80.

Purchaser	Number	Type			Total
		A	B	C	
Shellers	51	2,733.3	467.4	87.4	3,289.0
Other ^a	64	72.1	14.4	4.9	91.3
Total	115	2,805.4	481.8	92.3	3,380.3

^aUnidentified handlers: Type A - Commercial quota; Type B - Additional contract; Type C - Handler Buyback. The buyback provision of the price support program allows handlers to immediately buy back additional peanuts from the additional loan with no penalty.

Source: Summarized by the author from USDA files.

Table 3. Four-Firm Concentration Ratio for Peanut Shellers in the Major Peanut Production States, 1979-80.

State	Four-Firm Concentration ^a Percent	Number of Firms ^b Number
Alabama	91	16
Florida	100	4
Georgia	60	40
North Carolina	88	30
Oklahoma	100 ^c	3
Texas	94	11
Virginia	81	15
United States	45	*d

^aPercentage of the total crop purchased by the largest four shellers.

^bTotal first handlers, whether identified as shellers or not.

^cThree firm ratio.

^dDoes not sum to total firms since firms purchased in more than one state.

Table 4. Acquisition of Farmers' Stock Peanuts in the U.S. According to Buyer Participation in 1979.

Type of Purchase	Quantity Mil. pounds
Commercial Quotas	2,805
Contract Additional	483
Buyback Additional	92
Quota Loan Redemption	17
Additional Loan Redemption	150
CCC Crush (all loans)	428
Total Acquisition ^a	3,975
Total Production Estimate ^b	3,976

^aSummarized by the author from CCC records.

^bCrop Production, 1979 annual summary.

Table 5. Apparent Consumption of U.S. Peanuts in 1979 By Major User.

Utilization	Quantity Mil. pounds
Peanut Candy	465.041
Salted Peanuts	512.773
Peanut Butter	1,323.047
Other Products	89.370
Unshelled (Roasting) ^a	140.000
Sub-Total	2,530.231
Export ^b	977.606
Peanut Oil (from CCC Crush)	427.936
Total ^c	3,935.773

^aPeanut Stocks and Processing reports production of roasting stock to be 183.831 million pounds. Disappearance was 201.441 million pounds. Based on export data showing about 60 million pounds, U.S. consumption was estimated to be 140 million pounds.

^bEdible shelled, oil stock shelled and edible unshelled.

^cFarmer's Stock basis.