# Trade and the Political Economy of Agricultural Policy: The Case of the United States Peanut Program

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*Abstract*

NAFTA and GATT will dramatically alter regulations protecting U.S. peanut markets and will allow foreign producers considerable access to domestic market. Traditionally, the political economy surrounding peanut policy has been favorable to domestic producers. Rising peanut butter imports, decreasing domestic demand, and possibly the inadvertent effects of domestic policy, ironically implemented to protect domestic producers, have contributed to significant increases in Treasury costs. These increased Treasury costs have dramatically changed the political climate surrounding the peanut program. In this light, the effects of GATT appear manageable; NAFTA may ultimately require major policy reform. Possible alternatives are presented.

**Key words: agricultural policy, GATT, NAFTA, peanuts, trade.**

The peanut industry is regulated by the federal government through marketing quotas, support prices, and an import quota. Throughout the history of the peanut program, policy changes have been motivated by rising Treasury costs. These costs have generally been the result of changing market conditions brought about domestically. They involved unilateral changes in general trade policy due to war, dramatic increases in the productivity of domestic peanut producers, and out-dated policy. Today the causes are more global in origin. The most important of these is the rise in imports of peanut butter and the recent trade negotiations that likely will necessitate future program modification.

The effects of the global shocks are important for a variety of reasons. Peanuts are a major commodity in the South. Peanuts represent 11 percent of the cash receipts of all crops in the Southeast production region (Alabama, Georgia, and Florida), 9 percent of the cash receipts in the North Carolina-Virginia area, and 5 percent of the cash receipts in Oklahoma and Texas.[1] Moreover, peanut production is highly concentrated within these states. As a result, peanuts are often the cash crop for producers and a major industry to local rural economies. Finally, previous policy modifications occurred not because of the external shock itself, but rather due to the resulting rise in Treasury costs associated with the peanut program. The 1995 farm bill represents a crossroads for the future of the peanut program.

This research examines the effect of peanut and peanut product imports on the integrity of the peanut program and analyzes how these imports offset the price-supporting effects of the program. It provides an analysis of the political economy in which past and present policy has been formed. It analyzes the current effects of peanut product imports. Finally, it looks to the potential effects of the North American Free Trade Agreement (NAFTA) and the Uruguay Round of the General

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Agreement on Tariffs and Trade (GATT), suggesting possible policy changes to prevent high government expenditures and preserve the political viability of the peanut program.

**Peanut Policy**

Government programs for peanuts have been in effect since 1934.[2] Initially the government supported farm incomes through benefit payments to producers. Participation in the program required producers to reduce their planted acreage. As part of the program, regional growers' associations bought specified quantities of peanuts at USDA established prices. These peanuts were then diverted into the crush market, with the USDA absorbing any losses. The USDA projected that the diversion of peanuts from the edible market would foster higher prices. Acreage expansion from nonparticipants, however, defeated the program. In response the USDA established marketing quotas in 1941. World War II, however, caused the suspension of these quotas. They were reinstated in 1949.

The Agricultural Act of 1949 established acreage allotments for peanuts, thus limiting the total amount of peanuts produced. Prior to 1978, all peanuts from these allotments were guaranteed the support price. In 1978 a poundage quota was established for peanuts. The level of quota is set annually to meet expected domestic edible demand given the support price. From 1978 to 1981, total production was limited by acreage allotments, but only quota peanuts were guaranteed the support price. In 1982 acreage allotments were suspended. The support price remained guaranteed only to quota peanuts, but total domestic production was not limited.

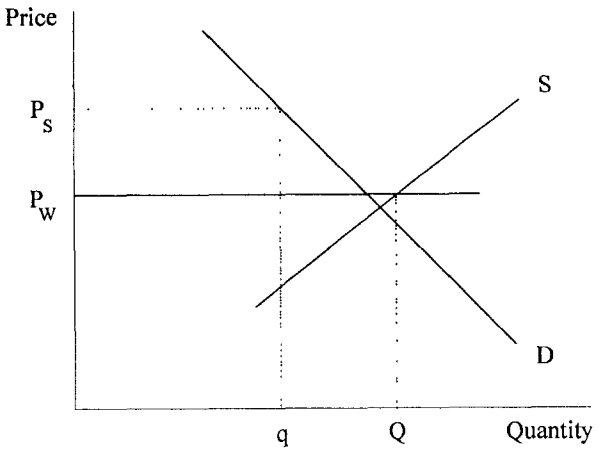
The establishment of quota peanuts (as only a portion of the total allotment) in 1978 brought about the production of "additional" peanuts, the term applied to those produced in excess of quota. Only quota peanuts can be sold directly into the domestic edible market. Quota peanuts can be sold directly to handlers or put in loan to the Commodity Credit Corporation (CCC) through the regional growers' associations. In either case, the producer is guaranteed a minimum support price. Additional peanuts can be contracted to handlers for sale in the export market or put under loan to the CCC in additional pools.[3] If put in loan, the producer is guaranteed the *additional* support price, a price set at only a small fraction of the value of quota peanuts. Additionals placed in loan, however, can be bought back, at a minimum of the quota support price, into the domestic edible market if demand exceeds the level of quota. The average price that producers receive by placing peanuts in loan thus depends upon the quantity of buybacks and the price paid by handlers for them. A priori, the expected price should be the price for contracted additionals.[4]

Additionals may not be marketed directly for domestic edible uses. Peanuts illegally marketed in this manner receive a penalty of 140 percent of the quota support price. Imported peanut products made from additional peanuts are subject to the same penalty. A final regulation issued in 1978, prohibited the export of peanut products made with additional peanuts to Canada and Mexico. The rationale for the 1978 rule came from the belief that it would be too difficult to prevent the reimportation of these products back into the United States. The USDA suspended this regulation for the 1992-95 marketing years.

The basic operation of the current program is illustrated in figure 1. The government sets the quota level, q, equal to expected demand at the quota support price, $P_s$. Individual farmers will produce until the marginal cost of production equals the price for contract additionals. Since contract additionals are exported, the contract price is determined by the expected world price. Total production is then set where the supply curve, S, intersects with the world price, $P_w$. At the time of harvest, actual demand may be greater or less than the government determined quota. If demand exceeds quota production, additionals will be bought back into the domestic edible market. If demand is less than quota production, a surplus exists. This surplus will be placed in loan and sold into the crush market at a loss to the U.S. Treasury.[5]

A variety of reasons exist for surplus quota peanuts held by the government. The first is simply an incorrect estimate of the domestic demand by the USDA. The second deals with the carryover provision. When producers fail to meet their quota,

**Figure 1.** United States Peanut Market: General Operation of the Current Peanut Program



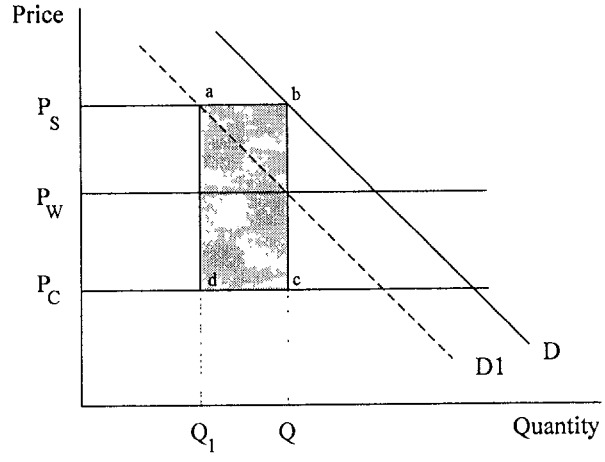

they can carry the quantity of these undermarketings into future growing seasons.[6] While the estimate of U.S. consumption may be correct, a large quantity of carryover can flood the market. By regulation, the USDA sets basic quota equal to expected demand. Effective quota, the sum of basic quota and allowable carryover, is the actual quantity that producers can market for edible purposes. Referring to figure 1, q would represent basic quota and effective quota would fall somewhere to the right, the quantity of carryover equaling the surplus.[7] The third is displacement of demand for domestic peanuts by imports of either actual peanuts or peanut products.

Figure 2 depicts the U.S. edible peanut market when a surplus exists. $D$ is the expected domestic demand for U.S. peanuts. Given $D$, the poundage quota, $Q$, and the support price, $P_s$, are chosen to clear the market. Suppose that $D_1$ is the actual demand curve for domestic edible peanuts, due either to incorrect estimation, carryover, or displacement from imports. This causes a surplus of $(Q\text{-}Q_1)$ that must be purchased by the government at $P_s$ and ultimately sold into the crush market for $P_c$. The diversion occurs to maintain the edible market price at $P_s$. As indicated in the figure, $P_c$ is considerably less than the world price, $P_w$. The result is Treasury costs in the amount equal to the shaded area labeled abcd in figure 2.[8] The effects, both economic and political, of such surpluses will be addressed in the discussion below.

To protect the domestic program, an import quota placed on foreign produced peanuts was initiated in 1953 (Schaub and Wendland). This quota limits imports to 1,709,000 pounds (shelled basis) per marketing year -- August 1 through July 31. This equals approximately one-tenth of 1 percent of annual total domestic edible demand. This quota occasionally has been relaxed because of extreme shortfalls in domestic production. (e.g. 1980 and 1990 were both years in which severe weather and disease greatly lowered domestic production.) This quota, however, does not limit the imports of most peanut products, specifically peanut butter and peanut paste, confectionery products, and mixed nuts containing peanuts.

The major peanut products are peanut butter, peanut candy or confectionery, and snack peanuts, either shelled or inshell. In theory, the import quota is designed to limit the importation of all peanut products except peanut butter. In reality, peanuts in confectionery products typically are not credited against the import quota. Instead, they are classified as candied nuts under the broad heading of sugars and confectionery. Though levied with tariffs, these imports are not restricted by quotas (other than those on sugar). Mixed nuts can enter in bulk or as packaged products. The former must be separated by type of nut and classified separately. Bulk peanuts are limited by the import quota. Packaged mixed nuts, however, are credited under their own category. While the tariff for this

**Figure 2.** United States Peanut Market: Treasury Cost Resulting from Excess Supply of Quota Peanuts




classification typically is higher than that for other peanut categories, no limit on imports exists.

The final product, peanut butter, has been the topic of much recent discussion. Peanut butter has its own classification and tariff rate. It was not restricted by a quota and, as previously stated, imports had risen dramatically in recent years. The U.S. Food and Drug Administration has a specific definition of peanut butter. Peanut paste, however, which is basically ground peanuts, does, usually, meet this definition and is classified as peanut butter when imported. In the rare instances where peanut paste does not meet the definition of peanut butter, it is classified as other prepared and preserved and limited by the quota.[9]

The historical ad valorem and per-unit tariffs on these products are illustrated in figures 3 and 4. The tariff rate on peanut butter remained steady at 7 cents per pound until 1979. By 1981 the tariff had fallen by more than 50 percent to 3 cents per pound, where it remains today. The tariff rate on mixed nuts prior to 1989 was based on the highest tariff rate for any nut in the mixture (18.5 cents per pound for almonds). These are seen in figure 3. As seen in figure 4, since 1989 an ad valorem tariff rate of 28 percent has been in effect for mixed nuts. Also seen in figure 4 is the ad valorem tariff rate on candy. This rate fell rapidly during the late 1960s and early 1970s, falling from a high of 14 percent to 7 percent. These reductions have increased the potential for material interference in the peanut program due to product imports.

## Treasury Costs: A Catalyst for Reform

Prior to implementation of the peanut program 10 to 20 percent of U.S. edible consumption was imported. Since the program's origin these imports have been effectively prohibited by tariffs and/or quotas. Further, until recently, peanut product imports have been virtually nonexistent. Despite this import protection, politically unacceptable Treasury costs have been a recurring problem for the peanut program. Initially the problem stemmed from nonparticipants that increased their supply to the edible markets while the government paid program participants to divert production to the crush markets. The diversion was costly to the government but did little to raise the market price of peanuts. Later, problems arose due to the national legal minimum acreage allotment, set at 1.61 million acres by the Agricultural Act of 1949.

Although on occasion the actual allotment was higher, the legal lower limit never changed. All peanuts produced within the acreage allotments were guaranteed the support price. Initially the minimum acreage presented no problems -- thanks in large part to the import quota. Technical progress and the incentives of an acreage allotment program, however, caused average yields to more than double during the two decades between 1950 and 1970.[10] Table 1 illustrates the rapid increase in yields and the resulting increases in production and Treasury costs that occurred following the implementation of acreage allotments. By the end

**Figure 3.** Per-Unit Tariff Rates on Peanut Products

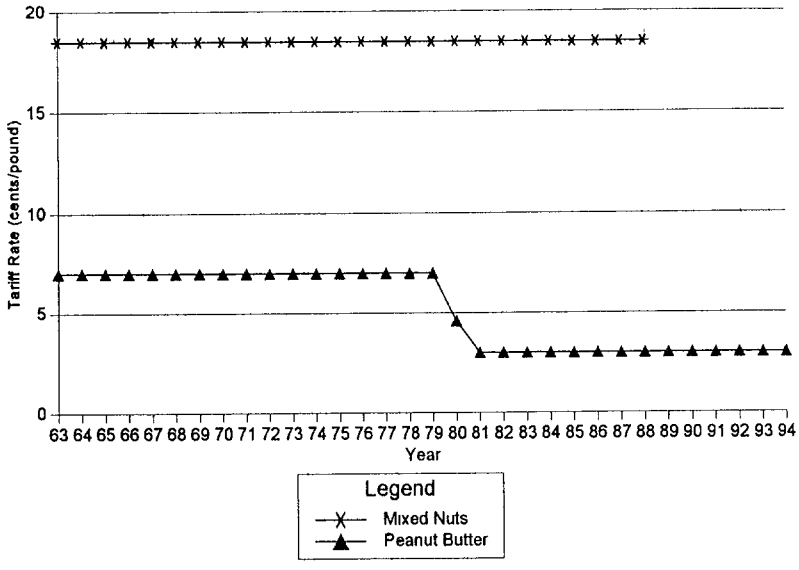
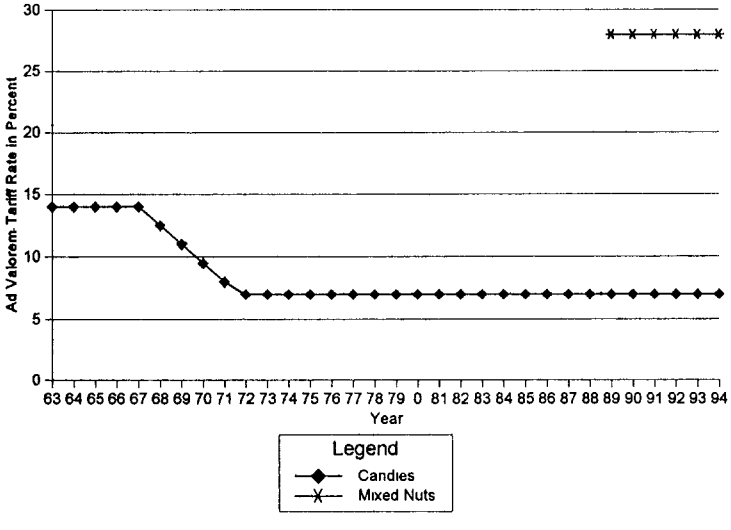



**Figure 4.** Ad Valorem Tariff Rates on Peanut Products




of the 1960s, Treasury costs of the peanut program were on the rise and talk of changes in the program began. The program was modified in the Food and Agricultural Act of 1977, with adoption of two-tier prices and poundage quotas.

Because allotments, and now quota, cannot be transferred across county lines, production has remained concentrated in the same areas as when the program began. Areas that have traditionally grown peanuts depend upon the industry and the support it receives through the program. Further, processing sites have developed in these same regions, adding shellers and non-grower industry workers to those opposing change. More efficient producing areas are currently blocked out of the domestic edible market because they have no access to quota. These more efficient producers would be able to adapt more easily to program modifications that would lower government costs. Coalitions of additionals producing farmers have organized in both Georgia and Texas to lobby for policy that is more favorable to their interests than those of the current quota holders. The typical producer in these

**Table 1.** Program and Production Statistics: 1950-1993

| Year | (1) Acreage Allotment | (2) Acreage Harvested | (3) Yield | (4) Production | (5) Treasury Losses |
|---|---|---|---|---|---|
| 1950 | 2,200 | 2,262 | 900 | 2,035 | 17.1 |
| 1951 | 1,889 | 1,982 | 837 | 1,659 | 9.4 |
| 1952 | 1,706 | 1,443 | 940 | 1,356 | 4.8 |
| 1953 | 1,679 | 1,515 | 1,039 | 1,574 | 14.0 |
| 1954 | 1,610 | 1,387 | 727 | 1,008 | 0.0 |
| 1955 | 1,731 | 1,669 | 928 | 1,548 | 17.1 |
| 1956 | 1,650 | 1,384 | 1,161 | 1,607 | 20.2 |
| 1957 | 1,611 | 1,481 | 969 | 1,436 | 6.1 |
| 1958 | 1,612 | 1,516 | 1,197 | 1,814 | 21.2 |
| 1959 | 1,612 | 1,435 | 1,061 | 1,523 | 11.4 |
| 1960 | 1,612 | 1,395 | 1,232 | 1,718 | 16.7 |
| 1961 | 1,612 | 1,398 | 1,185 | 1,657 | 12.1 |
| 1962 | 1,613 | 1,400 | 1,228 | 1,719 | 21.2 |
| 1963 | 1,612 | 1,396 | 1,391 | 1,942 | 28.3 |
| 1964 | 1,613 | 1,397 | 1,502 | 2,099 | 30.5 |
| 1965 | 1,613 | 1,435 | 1,661 | 2,390 | 44.3 |
| 1966 | 1,613 | 1,421 | 1,700 | 2,416 | 43.8 |
| 1967 | 1,613 | 1,404 | 1,764 | 2,477 | 48.2 |
| 1968 | 1,613 | 1,438 | 1,771 | 2,547 | 38 8 |
| 1969 | 1,612 | 1,456 | 1,741 | 2,535 | 36.0 |
| 1970 | 1,613 | 1,469 | 2,031 | 2,983 | 99 3 |
| 1971 | 1,613 | 1,455 | 2,065 | 3,005 | 97.3 |
| 1972 | 1,610 | 1,486 | 2,204 | 3,275 | 58.5 |
| 1973 | 1,610 | 1,496 | 2,322 | 3,474 | 4.8 |
| 1974 | 1,610 | 1,472 | 2,492 | 3,668 | 82.7 |
| 1975 | 1,614 | 1,500 | 2,565 | 3,847 | 138.9 |
| 1976 | 1,614 | 1,518 | 2,447 | 3,715 | 39.4 |
| 1977 | 1,614 | 1,512 | 2,464 | 3,726 | 9.8 |
| 1978 | 1,614 | 1,509 | 2,619 | 3,952 | 18 0 |
| 1979 | 1,614 | 1,520 | 2,611 | 3,968 | 49.8 |
| 1980 | 1,614 | 1,400 | 1,645 | 2,303 | 19.6 |
| 1981 | 1,739 | 1,489 | 2,674 | 3,982 | 8 0 |
| 1982 | suspended | 1,277 | 2,694 | 3,440 | 4 4 |
| 1983 | | 1,374 | 2,399 | 3,296 | 6.1 |
| 1984 | | 1,528 | 2,883 | 4,406 | 0 8 |
| 1985 | | 1,467 | 2,810 | 4,123 | 44.5 |
| 1986 | | 1,535 | 2,408 | 3,697 | 8.5 |
| 1987 | | 1,547 | 2,337 | 3,616 | 4.8 |
| 1988 | | 1,628 | 2,445 | 3,981 | 6.4 |
| 1989 | | 1,645 | 2,426 | 3,990 | 2 8 |
| 1990 | | 1,810 | 1,991 | 3,603 | 9.3 |
| 1991 | | 2,016 | 2,444 | 4,927 | 95.1 |
| 1992 | | 1,672 | 2,562 | 4,284 | 10.2 |
| 1993 | | 1,637 | 2,032 | 3,327 | 2 7* |

* Estimated losses

Notes: Column (1), in thousand acres; Column (2), in thousand acres, Column (3), in pounds per acre; Column (4), in million pounds; Column (5), CCC net realized losses in million dollars

Source: Column (1) - (4), *Fats and Oils Situation* and *Oil Crops: Situation and Outlook*, USDA; Column (5), US Tariff Commission Report to the President (June 1, 1953), Rucker and Thurman (1990), and USDA, Agricultural Stabilization and Conservation Service

organizations produces little or no quota peanuts and lives in a county having a small allotment of quota. The short run negative impacts on the "traditional" production regions have often provided a formidable political barrier to change. Outside forces now challenge their political power.

*The Present Crisis: Peanut Product Imports*

Though initially opposed by most producers, the quota program quickly acquired solid support and appeared firmly established throughout most of the 1980s. By the end of the 1980s,

however, producers were nervous about the future of the peanut program. At that time President Reagan suggested Section 22 of the Agricultural Adjustment Act of 1933 as a potential bargaining chip in the GATT negotiations. Further, producers worried that the newly approved United States-Canada Free Trade Agreement (CFTA) would allow exports of peanut products containing additional peanuts to Canada -- a recurring request of manufacturers since the initial ban on such exports in 1978. They argued that they were unable to compete in the Canadian peanut product markets because Canadian manufacturers purchased relatively cheap additional peanuts from the United States, whereas U.S. law mandated the use of high-priced quota peanuts in their exports.

The CFTA, however, revoked neither Section 22 protection nor the ban on product exports. Further, at the end of 1990, Congress passed a near identical peanut program that extended through 1995. Adverse weather in the Southeast, however, resulted in a short 1990 crop. In response to a request by manufacturers, late in the 1990-91 marketing season the U.S. International Trade Commission (USITC) recommended a one-year increase in the import quota for peanuts. President Bush relaxed the import restrictions, but by this time less than one month remained in the marketing year and until the harvest of the 1991 crop. The 1991 crop was the largest in history.

What transpired during the 1991-92 marketing year ultimately caused the largest Treasury costs for a single year since 1975. The peanut program came under intense scrutiny. An investigation by the General Accounting Office (GAO) began to examine the role of peanut policy and suggest possible changes. The GAO's report, released in February 1993, criticized various aspects of the program and called for substantial changes in the peanut program, several of which involved moving the industry in a more market oriented direction. This supported the position taken for many years by manufacturers.

Growers and shellers did not agree.[11] The general consensus among growers and shellers on the cause of the 1991-92 Treasury losses was threefold: 1) the extra imports allowed under a relaxation of the Section 22 quota due to the short 1990 crop, 2) the USDA's over-estimation of domestic demand, and 3) the increase in peanut butter imports. Witnesses at congressional hearings had varying suggestions on how best to prevent future Treasury losses. The item upon which they, growers and shellers, agreed was that a limit on the imports of peanut butter must be enacted. The other suggestions, however, help to illustrate the differences between quota growers, additional growers, and shellers.

All growers agreed that the quota needed to be more accurately set and, specifically, the USDA needed to account for carryover. The 1990 drought resulted in the full 10 percent legal maximum national carryover occurring in 1991. Virtually all of which was sold to the CCC. An additional suggestion of the growers required all imports, peanut butter and raw or processed peanuts, to meet the same quality standards as U.S. peanuts. This point was especially supported as a necessary requirement for all potential imports under the NAFTA and the GATT.

More far-reaching suggestions came from additional growers[12]. In hearings before the House Subcommittee on Specialty Crops and Natural Resources, they first called for an end to carryover. They cited it as a significant factor contributing to high Treasury costs. Further, they believed that federal crop insurance could provide adequate protection for unforeseen shortfalls in production to cover growers' costs of production and the value of quota. Second, they wanted to end the cross compliance within area association pools. Currently, profits in the additional pools are used first to offset losses in the quota pools of any region before being distributed to the growers who placed additionals in loan. Producers who grew additionals exclusively believed themselves unfairly penalized, subsidizing quota losses when they did not share in quota profits. To offset this, they suggested assessments against all quota peanuts placed in loan to cover the costs of administering the program. A similar suggestion called for peanuts placed in loan to receive some price less than the support price to increase the incentive to market peanuts through the shellers rather than through the government loan. Finally, they called for an end to the restriction on the transfer of quota across county borders. This would aid additional producers by providing them with greater access to quota through purchase or lease. The obvious efficiency argument follows

that, without restrictions, quota would move to locations that can produce the best quality peanuts at the lowest price. Those in traditional peanut-producing areas were opposed to this suggestion.

The shellers concurred on the need to limit peanut butter imports, but they favored lower support prices rather than reductions in quota. Since shellers' profit by volume this makes sense. They must strike a balance with growers, however, because they profit from larger U.S. consumption only when the supply to manufacturers comes from U.S. producers rather than foreign imports.

The interests of manufacturers are quite different. To the extent that they comment on the program, they generally prefer larger quota allotments. A larger national quota reduces the possibility of a domestic shortfall and prices rising above the support price. They also favor unrestricted sale and lease of quota to facilitate movement of production to the most efficient growing regions. In fact, the American Peanut Product Manufacturers, Inc., whose members represent over 50 percent of domestic peanut use, opposed continuation of the peanut program during the planning of the 1981 and 1985 Farm Bills. In 1990 they took what could be viewed as a more conciliatory stance. (See "Formulation of the 1990 Farm Bill (Peanut Program)," hearings before the Subcommittee on Tobacco and Peanuts of the Committee on Agriculture.) They called for higher quota levels, a freeze on the support price, and reiterated their request for elimination of transfer restrictions on quota to increase efficiency in production. Still, while manufacturers obviously would like to purchase peanuts at the lowest possible price, they do realize the need for the highest quality peanuts to guarantee the quality of their products. They illustrate this by the fact that primary utilization of peanut butter imports occurs through institutional channels. The three major peanut butter manufacturers, to date, have not imported peanut butter or paste for retail sale.

The concern over peanut butter imports ultimately led to a request for the USITC to examine the impact of peanut butter imports on the operation of the peanut program. Early in 1994, the President indicated his willingness to invoke Section 22 protection. Two days prior to hearings on the issue the USITC received a request from the President to suspend the investigation indefinitely; this was done. The other suggestions largely remained just that, because no action was taken by either Congress or the USDA. Regulations on quota transferability, profit sharing among the association pools, and the official estimation of domestic demand remained unchanged. The one change that did occur was the suspension of the prohibition on exports to Canada and Mexico of peanut products made with additionals for the 1992-95 crops.

## Trade Agreements, Product Imports, and Treasury Costs: New Policy for the 1990s?

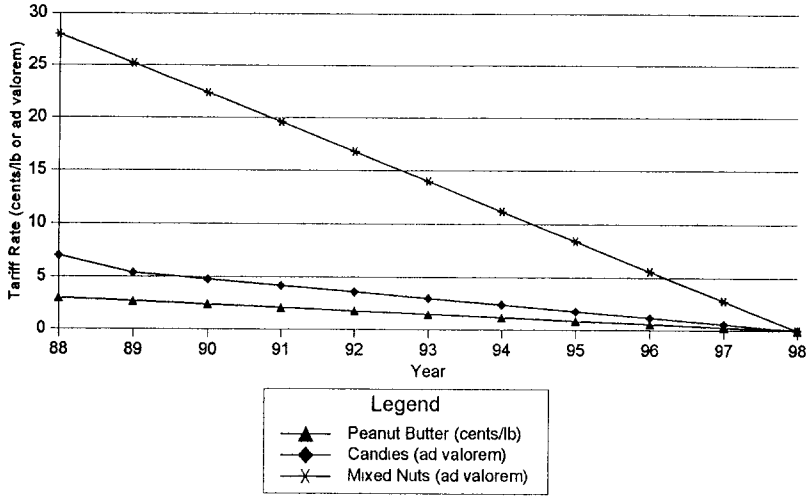
A separate issue is the impact of peanut butter, and all other peanut product, imports. The increase in peanut butter imports, though largely from Canada, is not likely the result of the CFTA. In fact, domestic peanut policy suggests U.S. regulations as a possible cause.

### *United States-Canada Free Trade Agreement*

The CFTA took effect in January 1989. The agreement allows for different implementation periods to reduce tariffs and customs fees on goods traded between the United States and Canada. For most agricultural products, including blanched and processed peanuts and all peanut products, the implementation period to eliminate tariffs is 10 years. A straight-line method is followed, with the first reduction occurring in 1989 and tariffs eliminated by 1998. The tariffs on peanut butter and blanched and processed peanuts fell to 2.7 cents per pound in 1989 and have continued to fall by 0.3 cents per year. The tariffs on candied nuts and mixed nuts were lowered to 5.4 and 25.2 percent ad valorem, falling an additional 0.6 and 2.8 percent per year. Figure 5 shows the path of peanut product tariffs during the 10-year implementation period. The tariffs on raw, shelled, or inshell peanuts follow a different pattern. After falling to 2.7 cents per pound in 1989, the tariff was completely eliminated in 1990. The decrease is inconsequential given that Canada does not produce peanuts. Any imports from Canada would not meet the rule-of-origin criterion.

An important feature of the CFTA is the regulations imposed regarding rules of origin. Products entering the United States must be deemed as Canadian products and not those of a third

**Figure 5.** Peanut Product Tariff Rates under the CFTA




country, funneled through the Canadian market to receive the lower tariff rate. To qualify, processing must occur in Canada that changes the classification of the product to a different tariff code. In the case of peanuts, this involves importing raw peanuts and processing them into peanut butter, candied nuts or ready-to-eat mixed nuts.

*Peanut Butter Imports: The Result of the CFTA or Other Factors*

As seen in table 2, though the tariffs on all peanut products have declined with implementation of the CFTA, only peanut butter imports have shown a significant gain in the last several years. A second point is the initial tariff was only 3 cents per pound. Making the necessary conversions, this is approximately 5.67 cents per pound of raw inshell peanuts,[13] a value far below the differential between the support price and the world price. The CFTA tariff for 1994 is 1.2 cents per pound or approximately 2.27 cents per pound of farmer stock peanuts. This 3.4 cent drop is minimal when compared to the roughly 15 cent difference between the world price and the support price. Finally, even if one were to argue that this slight tariff reduction was just enough to start the flow of imports that would not explain the simultaneous increase in imports from other countries, namely Argentina, that have not received the benefits of lower tariffs.

Still, imports are rising rapidly. The extent to which these imports displace domestic peanuts through domestic peanut butter consumption is illustrated in table 3. In ten years peanut butter imports have grown to represent over 10 percent of the domestic market. Two possible scenarios might explain the rise in imports. For the first, one can look at the Argentina peanut industry. The imports from Argentina are largely peanut paste, crushed peanuts without the typically added sugars, salt, and stabilizers. Argentina only became a major producer and exporter of peanuts in the past decade. Their rapid increase in exports could reasonably be explained as normal progressive growth within the industry. As the Argentine industry developed, it expanded production and exported its excess supply, first in the form of raw products and later in the form of processed products as they developed the necessary infrastructure. Most peanuts used for peanut butter production in Canada are from China. While China long has been a major producer of peanuts, their current influence in the export market for edible peanuts began only slightly before Argentina's. It is possible that as China's exports increased, Canadian rather than Chinese firms developed the processing facilities for the excess supply.

A second possibility stems from the 1978 change in policy. At that time the United States allowed for the export of additional peanuts to Canada but not peanut products made from additional peanuts. This provided Canada the opportunity to produce its own peanut products from inexpensive, yet high quality U.S. peanuts.

**Table 2.** Imports of Peanuts and Peanut Products: 1975-1993

| | ----- Peanuts (pounds shelled basis) ----- | | | | | |
|---|---|---|---|---|---|---|
| Year | Raw | Prepared | Total | Peanut Butter | Mixed Nuts | Candied Nuts |
| 1975 | 17,104 | 531,169 | 548,273 | 0 | 10,016 | |
| 1976 | 6,188 | 758,469 | 764,657 | 1,000 | 1,436 | |
| 1977 | 99,111 | 504,324 | 603,435 | 0 | 1,524 | |
| 1978 | 16,895 | 605,048 | 621,944 | 0 | 4,167 | |
| 1979 | 25,125 | 552,698 | 577,823 | 1,000 | 1,388 | |
| 1980 | 161,683 | 953,386 | 1,115,069 | 500 | 14,890 | |
| 1981 | 1,091,108 | 306,011,102 | 307,102,210 | 7,770,194 | 33,130 | |
| 1982 | 50,015 | 2,114,875 | 2,164,891 | 471,722 | 22,602 | |
| 1983 | 223,585 | 3,154,733 | 3,378,317 | 47,287 | 12,995 | |
| 1984 | 25,145 | 2,188,856 | 2,214,000 | 18,257 | 87,995 | |
| 1985 | 55,604 | 583,148 | 638,751 | 114,171 | 82,647 | |
| 1986 | 537,366 | 3,164,171 | 3,701,537 | 954,218 | 187,281 | |
| 1987 | 382,817 | 1,685,718 | 2,068,535 | 2,096,140 | 142,051 | |
| 1988 | 344,342 | 1,515,999 | 1,860,341 | 2,141,001 | 77,635 | |
| 1989 | 1,392,764 | 638,179 | 2,030,943 | 5,596,538 | 7,577 | 574,231 |
| 1990 | 871,587 | 1,641,375 | 2,512,961 | 7,957,435 | 140,357 | 513,759 |
| 1991 | 14,077,893 | 7,932,113 | 22,010,006 | 17,163,900 | 88,282 | 288,565 |
| 1992 | 329,088 | 3,133,543 | 3,462,631 | 26,533,718 | 38,457 | 397,954 |
| 1993 | 0 | 1,435,785 | 1,435,785 | 40,149,003 | 51,956 | 593,440 |

Notes: All values in pounds. All quantities are for calendar year imports Raw peanuts includes inshell peanuts converted to shelled basis by multiplying by 0 75 The series for candied nuts begins from 1989 due to the way these imports are categorized by the U.S. Customs office Prior to 1989 all peanut candies were generically lumped together with all other confectionery. Since 1989 a category for candied nuts (this includes all nuts) has existed. Thus the figures for candied nuts in Table 2 overestimate the quantity of peanut candies. Further, the weight is for the entire candy and not simply the nut portion.

Source: U.S. Department of Commerce, Bureau of Census.

**Table 3.** Peanut Butter Imports, Exports, and Domestic Consumption

| | (1) | (2) | (3) | (4) | (5) |
|---|---|---|---|---|---|
| Year | Domestic Peanuts Utilized in Peanut Butter | Peanut Butter Exports | Peanut Butter Imports | Domestic Peanut Butter Consumption | Import Share of Domestic Consumption |
| 1983 | 695,709 | 10,083 | 22 | 358,036 | 0.01% |
| 1984 | 723,377 | 10,074 | 90 | 372,755 | 0.02% |
| 1985 | 726,500 | 9,929 | 361 | 374,824 | 0.09% |
| 1986 | 709,244 | 12,929 | 2,065 | 364,398 | 0.55% |
| 1987 | 747,244 | 12,902 | 1,589 | 384,054 | 0.40% |
| 1988 | 860,301 | 14,575 | 3,817 | 444,428 | 0.84% |
| 1989 | 897,318 | 18,573 | 5,871 | 462,070 | 1.24% |
| 1990 | 742,384 | 18,683 | 14,304 | 388,416 | 3.64% |
| 1991 | 886,367 | 22,003 | 19,580 | 466,555 | 4.18% |
| 1992 | 797,910 | 22,278 | 35,731 | 435,178 | 8.46% |
| 1993 | 727,006 | 24,943 | 39,555 | 399,272 | 10.28% |

Notes: All quantities for Column (1)-(4) in thousand pounds. Data follow the crop or marketing year, August 1 through July 31. Domestic consumption is estimated as peanuts used in peanut butter times (0.528) plus imports less exports. The domestic utilization of peanuts in peanut butter are crop year values running from August through July. The quantity of exports and imports also are crop year values. The quantity for domestic consumption is estimated. Shelled peanuts used in peanut butter are converted to an approximate peanut butter basis by multiplying by 0.95. 0.95 is an industry conversion factor used by the National Peanut Council, Inc

Source: Column (1), Peanut Stocks and Processing (various issues); Columns (2) and (3), USDA Foreign Agricultural Service.

Once this infrastructure was in place, the Canadian processors could expand their production to peanut butter for industrial uses. These uses do not demand the same high quality allowing for the use of peanuts from other countries, namely China. Because these products were not made from additionals they could be exported to the United States. Under this scenario, a policy -- the prohibition of exports of peanut products made from additionals -- that was designed to protect the domestic peanut market may ultimately have caused U.S. producers to lose market share to foreign competitors.

*North American Free Trade Agreement*

The NAFTA, implemented in 1994, removed Mexico from the barriers of Section 22. Section 22 will be replaced with tariff rate quotas. The quota specifies the quantity of peanuts, called the minimum access level, that will be allowed into the United States at a zero or low tariff rate; all imports above this quantity will be taxed at a higher, more restrictive, tariff rate. The NAFTA will be phased in over a 15-year period. During the transition period the minimum access level will increase annually while the tariff rates for excess imports will decrease.

Mexico had an initial duty-free import quota of 3,377 metric tons (MT) of peanuts. This increases by 3 percent annually to 4,959 MT in 2007. The quota will be eliminated completely in 2008. No tariffs apply to the minimum access level. Imports above the annual quota level are allowed, but taxed. The 1994 rates were the maximum of 120 percent ad valorem or $0.783 per kilogram for shelled peanuts (raw or preserved) and the maximum of 181.4 percent ad valorem or $0.517 per kilogram for inshell peanuts. These rates will be reduced by 3 percent of the original level in the second through sixth years for a total 15 percent discount. The remaining tariff will be eliminated in a straight line method over the remaining 9 years. Figure 6 illustrates the decline in tariffs for peanuts.

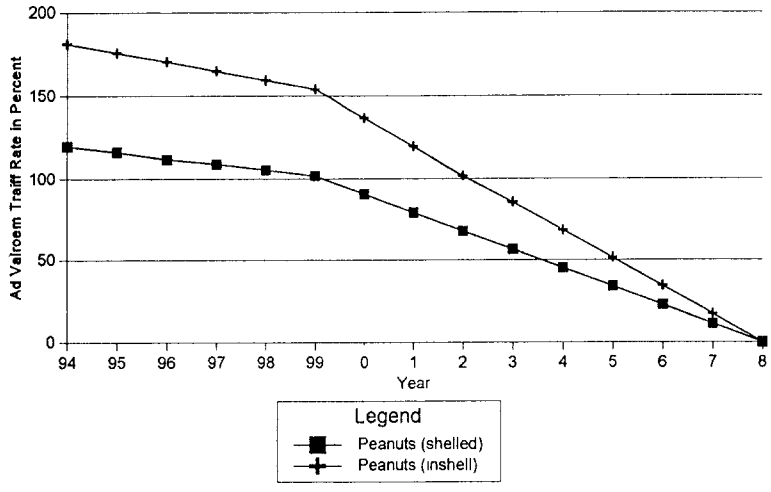
Finally, all peanut imports from Mexico must be *Mexican grown*. This includes peanut products such as peanut butter. It is this point that has allowed government officials to assert that NAFTA will have little effect on the domestic peanut market. Former Secretary of Agriculture Mike Espy stated that NAFTA will expand Mexico's economy and increase their demand for peanuts. Further, he did not anticipate that "Mexico can become a major supplier of peanuts to the United States because of their limited land for production and their limited shelling, processing, and storage facilities." (*Southeast Farm Press*, November 1993.)

*Uruguay Round of the General Agreement on Tariffs and Trades*

The GATT will implement further changes beginning April 1, 1995. The Uruguay Round, which ended in December 1993 after 7 years of negotiations, is a first attempt to open up agricultural markets. The GATT focuses on four specific obstacles to trade: market access barriers, export subsidies, internal supports, and sanitary and phytosanitary restrictions. For peanuts the area of greatest importance is market access barriers. The GATT ends protection of all U.S. agricultural commodities under the auspices of Section 22. In general, the GATT requires that all non-tariff barriers be converted to their tariff equivalents. This equivalent is the difference between the average domestic price and the average world price. Further, countries must allow foreign access to the domestic market equal to at least 5 percent of consumption. The access quota is calculated based on consumption in a specified base period, 1986-88 for peanuts. Initially countries must only allow access to 3 percent of consumption, but these quotas must increase to the 5 percent requirement within the initial 6-year implementation period.

Now look more specifically at peanuts. As with the NAFTA, the GATT replaces Section 22 import restrictions with tariff rate quotas. The initial "access quota" or imports allowed with a nominal tariff is 33,700 metric tons, or 3 percent of average domestic consumption over the base period. This quantity increases to 5 percent of the domestic average (56,293 metric tons) by the sixth year. The tariff on "over-quota" imports is 155 percent for shelled and 192.7 percent for inshell peanuts. The tariff rates are illustrated in figure 7. The minimum access quota excludes imports from Mexico which may rise at the rates specified in the NAFTA. The

**Figure 6.** Peanut Tariff Rates under the NAFTA




tariff schedules also differ; Mexico is on the earlier time table of the NAFTA. A side agreement further guarantees Argentina 78 percent of the minimum access level.

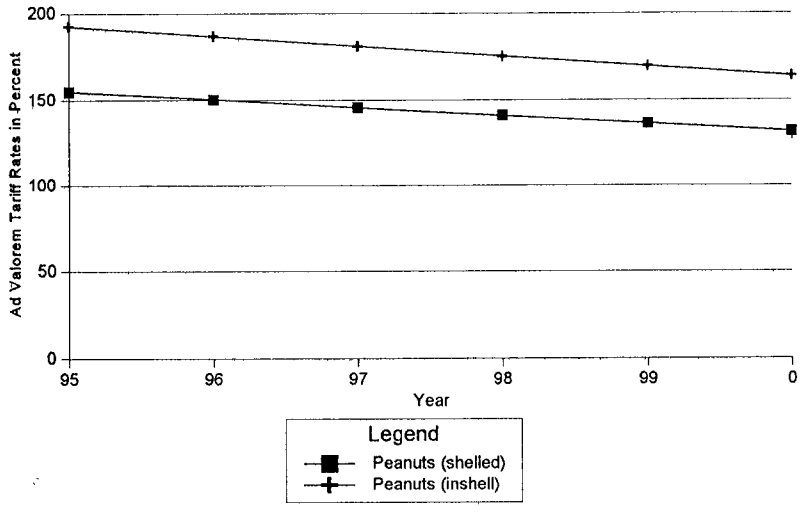
Corresponding with the allotment to Argentina is a change in the quota year. The marketing year for U.S. peanuts traditionally has run from August through July. USDA publications report statistics on peanuts and peanut markets based on this period rather than on the calendar year. The current import quota also follows this time pattern. The GATT changes the "quota year," the period to which the stated import limitations apply, to an April through March season. There are two apparent explanations. First, imports are accepted into the United States on a first-come first-served manner. Competition to export peanuts into the United States market results in most, if not all, of the quota being filled in the beginning of the quota year. This occured concurrently with the United States harvest, when an abundance of peanuts already filled the market. The desired effect of shifting the quota year includes providing a better supply flow and reducing price variability. Second, the change is logistically sound given Argentina's 78 percent share of the minimum access quota. The beginning of the quota year now immediately follows Argentina's harvest.

GATT also establishes a separate quota for peanut butter (and peanut paste) -- this in spite of the fact that U.S. peanut butter markets never received protection under Section 22. The quota is set at 19,150 metric tons, approximately equal to the 1993 level of imports. This quota provides for specific allocations to Canada and Argentina in addition to allocations to broad categories of countries. Canada's allotment is 14,500 metric tons. Argentina is allowed imports up to 3,650 metric tons. Less developed countries have an initial allotment of 750 metric tons, increasing over the six-year implementation period to 1,600 metric tons. The remaining 250 metric tons will be dispersed to other countries. Argentina qualifies as a "less developed country," and thus it may export more than 3,650 metric tons to the United States. Mexico is not included in this quota on peanut butter. Mexico may export an unlimited amount of peanut butter to the United States provided it contains only Mexican-grown peanuts. The in-quota tariff rate for all countries follows the schedule established for Canada under the CFTA. Thus, the in-quota tariff will be eliminated by 1998. The over-quota tariff rate will be 155 percent. This rate will fall by 15 percent over the first six years to 131.8 percent. The quota year for peanut butter will follow the calendar year.

*Interaction of the Trade Agreements and Their Combined Effects*

In general, there is little conflict between the CFTA, the NAFTA, and the GATT. The GATT allows for bilateral trade pacts as long as they do not raise the barriers to trade for nonparticipating

**Figure 7.** Peanut Tariff Rates under the GATT




countries. The CFTA and the NAFTA meet this criterion. Since they remove virtually all barriers to trade and do so at a faster pace than the GATT, in general, there are no conflicts. There is one caveat to this generalization: the conversion of non-tariff barriers to tariffs by GATT and whether this is allowed by the CFTA, an agreement that reduces *all* tariffs between the United States and Canada to zero.

Both countries agree that the CFTA takes precedence over the GATT because the GATT allows such bilateral agreements. The United States contends that the CFTA (and now the NAFTA which replaces it) does not allow the implementation of higher quotas or new quota restrictions. If true, then the tariffs on all products traded between the two countries will be zero with no market access restrictions. Canada contends that the CFTA allows for it to convert the pre-GATT non-tariff barriers to new tariffs. At issue is the interpretation of a particular clause in the actual agreement between the two countries. Each country is interpreting the clause differently. It is likely that the courts will ultimately decide which interpretation is correct.

What does this mean for peanuts? Given that the CFTA requires that imports receive the lower tariff rates only if they meet the rules of origin, peanuts should not be affected. Peanut butter might be, however. If the U.S. stance prevails, Canada would likely increase its peanut butter exports to the United States without paying over-quota tariffs. The United States would argue that the peanut butter limitation is a special agreement that amends the CFTA. It is doubtful, however, that the United States could prevail on both issues.

Working under the hypothesis that GATT effectively prevents any further increase in peanut butter imports, the cost to the United States is the eventual loss to foreign imports of 5 percent of the domestic edible peanut market. Rucker, Thurman, and Borges (1994) show that given the high over-quota tariff rates under the GATT, it is extremely doubtful that any peanuts beyond the minimum access level will be imported.[14] This agreement is a tradeoff that most growers would have preferred to avoid. However, given the President's non-action on limiting 1994 imports of peanut butter, producers ultimately may be thankful for the GATT. They have lost 56,293 metric tons of domestic edible market, but have prevented any further loss of the domestic peanut butter market to increasing foreign competition.

The domestic peanut program's future, however, looks less promising after close examination of the NAFTA. Former Secretary of Agriculture Mike Espy assured producers that Mexico does not possess the infrastructure necessary to pose much difficulty with the current program.

This view is questionable however. The NAFTA eliminates all tariffs on peanuts and peanut products by 2008. This provision allows Mexico 15 years to increase production, both through increased acreage and yields, and to develop the necessary infrastructure to mill and process a larger supply of peanuts. This argument was raised by grower representatives in hearings on the NAFTA prior to Congressional approval. (See *Southeast Farm Press*, December 1993.) Recent Mexican data on acreage, yields, production, imports, and consumption are shown in table 4. If Mexico were to double both its acreage and yields, its production would equal almost half of current U.S. edible consumption. After subtracting off Mexico's current consumption, excess supply would still exceed one-third of current U.S. edible consumption. Currently, Mexico's yields are about half those of the United States. Since the technology exists for higher yields, it is reasonable to believe that the promise of the high United States support price will cause utilization of this technology. Further, if U.S. exports of grains to Mexico increase as expected, land in Mexico could become available for expanded peanut production.

*GATT and NAFTA: Benefactors, Losers, and Policy Alternatives*

It is not clear who the ultimate beneficiaries and losers from the NAFTA and the GATT will be. Consumers are not likely to benefit since the price support system still exists. The marginal price of peanuts remains the quota support price. At the margin, costs to manufacturers and, thus, retail prices remain unchanged. The effect on all industry participants in the long-run depends upon how the program adapts to increased imports. Given the media attention that surrounds the peanut program, no action, which likely means increased government expenditures, is not a viable option. Possible alternatives include lowering the quota level, lowering the support price, or import restrictions.

Congress's approval of the GATT ceases import quotas under Section 22. Less explicit import restrictions, in the form of quality and environmental requirements, are possible deterrents. Both the NAFTA and the GATT have provisions regarding these issues. It is still unclear, however, what these regulations might be or how effective they will be in limiting imports.

The GATT limitation on peanut butter imports is certainly a victory for peanut growers and shellers. It is less clear how manufacturers view this quota. Initially, one would assume that manufacturers benefit from the availability of cheaper foreign peanut butter. Imports, however, have reached consumers largely through industrial channels. The major producers of peanut butter for retail sale continue to rely exclusively on domestic peanuts. One explanation stems from the quality difference between domestic and foreign peanuts. The story follows that the major brands do not want to risk their reputations on an inferior product. The validity of this assumption will be tested if and when Mexico expands its production and develops the necessary infrastructure to compete in the U.S. peanut butter market, either through direct sales of peanut butter and paste or through the sale of peanuts to U.S. manufacturers.

Regarding reforms to lower potential Treasury losses, decreasing the quota appears to be the optimal choice in the opinion of growers. It allows maintenance of the support price at its current level and continued production of additionals for export. Decreasing quota without reducing the support price, however, is potentially only a short-term solution that could not be maintained in the long-run. In the short-run lower national quota levels can eliminate the potential for government costs. Given the GATT agreement alone, this option would be a viable one to offset the minimum access requirement. If Mexican production increases because of increased acreage and/or more intensive production practices, the necessary reductions in quota may become excessive once imports are unrestricted.

The alternative is to lower the support price. Though not the choice of growers, this would seem to be the optimal proposal for shellers, manufacturers, and consumers. Lowering the support price would lower the price paid by shellers and manufacturers and thus consumers. Shellers, the first consumers, will see the entire savings. The degree to which prices to manufacturers and retail consumers fall will depend upon each sector's market power and their supply and demand

**Table 4.** Mexican Peanut Production, Consumption, and Trade

| Year | (1) Acres Harvested | (2) Yield | (3) Production | (4) Imports | (5) (US) Imports | (6) Crush Consumption | (7) Edible Consumption | (8) Edible Utilization |
|---|---|---|---|---|---|---|---|---|
| 1988 | 210 | 1,082 | 227.1 | 15.4 | 13.2 | 2.2 | 238 | 238 |
| 1989 | 210 | 1,049 | 220.5 | 24.3 | 24.3 | 2.2 | 240 | 240 |
| 1990 | 200 | 1,113 | 222.7 | 13.2 | 8.8 | 2.2 | 236 | 238 |
| 1991 | 195 | 1,242 | 242.5 | 24.3 | 19 8 | 4.4 | 260 | 262 |
| 1992 | 225 | 1,167 | 262.4 | 50.7 | 24.3 | 4.4 | 306 | 308 |
| 1993 | 222 | 1,140 | 253.5 | 57.3 | 30.9 | 4.4 | 304 | 306 |

Note: All data is for marketing year, August - July. Column (1) in 1,000 acres. Column (2) in pounds per acre. Columns (3)-(8) in 1,000 pounds. Column (4) is total imports from all sources. Column (5) is imports from the United States only. Edible Utilization includes consumption plus seed and feed uses.

Source: USDA Foreign Agricultural Service

elasticities. Lower prices for final products would increase the quantity demanded. Expansion of the market obviously helps manufacturers. Lowering the support price increases the competitiveness of domestic peanuts. This action, in conjunction with increased demand for peanuts from all sources, will maintain a larger flow of peanuts being marketed through domestic shellers, improving their situations. Finally, the suggested superiority of U.S. peanuts implies that a moderate support price that maintains a differential between the world price approximately equal to the premium afforded to U.S. peanuts for their higher quality, could be maintained in the long-run with no cost to the U.S. Treasury.

## Conclusion

Throughout the history of the peanut program, peanut policy has been modified to adjust to external shocks. In the early years of the program, these shocks were domestic in origin. Trade barriers effectively insulated the United States peanut and peanut product industries. Today insulating is no longer possible. While domestic critics vocalized their objections to the program, producers directed their primary attention to the trade agreements that threatened to remove import barriers.

The final effect of these trade negotiations on the domestic peanut industry is yet to be determined. In the past the political negotiations centered around a powerful block of the legislators representing growers. As discussion on the 1995 farm bill begins this may no longer be the case. The existing political economy has changed -- time will tell how much. Well before Congress' approval of the NAFTA or the signing of the GATT in the fall of 1993, the peanut program was under intense fire. Early in 1993 the General Accounting Office released a publication calling for substantial changes in the peanut program. This report supported the positions of various members of Congress who called for changes or complete elimination of the program. In addition to the critics of the peanut program, there are those hoping to cut agricultural subsidies across the board to reduce federal spending.

Peanut producers, however, prepared for a fight. They complained that the proposed trade agreements threatened their livelihoods. Articles in the popular press express farmer and grower representatives' concerns. They ultimately proved that they maintain considerable political clout in Washington. Both the NAFTA and the GATT were revised to appease grower concerns. All peanuts and peanut products imported from Mexico must come from Mexican-grown peanuts. Strict enforcement guidelines have been set out. The GATT agreement on peanut butter was designed to offset the likely increases in peanut butter imports.

The domestic peanut program's future, however, remains in doubt after close examination of the NAFTA. Despite the former Agriculture Secretary's assurances, the potential for Mexico to acquire the infrastructure necessary to greatly increase its peanut and peanut product exports does exist. This undoubtedly will affect peanut policy in the future. One potential option is stricter health

safety and environmental regulations. Many foreign countries allow the use of pesticides that are banned in the United States for health and/or environmental reasons. Regulations prohibiting the import of peanuts with any residue of U.S. banned chemicals are supported by producer groups. Other options include reductions in either the national quota or the support price, or both. Unchanged, the program appears destined for increased imports and Treasury costs increases. The 1995 farm bill offers an opportunity for all market participants -- producers, shellers, manufacturers, and consumers -- to compromise and put forth a workable and affordable program for the rest of the decade and beyond. What remains to be seen is if policy changes relating to potential material interference with the peanut program will be preventative or reactionary.

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**Endnotes**

1. See Carley and Fletcher (1993).

2. Rucker and Thurman (1990) explain in detail the workings of the peanut program. Schaub and Wendland (1989) provide a history of the legislation affecting the peanut industry.

3. There are six pools in each of the three existing regional associations, an additional and quota pool for each of the three segregations of peanuts. Placing peanuts "under loan with the CCC" and placing peanuts "in the pools" are different expressions for the same action.

4. See Rucker and Thurman for supporting analysis.

5. Quota peanuts placed in loan can be either sold into the domestic crush market or exported for edible use by the CCC. The minimum export price, however, is the support price plus any storage and handling costs. This price is well above the world and contract additional price--effectively prohibiting the export of any peanuts from the quota pools.

6. The major limitation to this policy is that total national carryover in a given year cannot exceed 10 percent of the current national quota allotment. If the 10 percent limit is met, producers whose undermarketings exceed 10 percent of their quota allotments must wait until the following season to carry over a portion of their excees undermarketings. The second limitation is that if a producer's basic quota is reduced because of failure to produce, his allowable carryover of undermarketings are similarly reduced.

7. This is true in theory. In reality, not all effective quota is actually produced and marketed. To some extent, carryover simply replaces the expected undermarketings for the current crop. The government accounts for neither expected undermarketings nor carryover when determining basic quota for the coming year.

8. Figure 2 illustrates the national peanut market. Individual regional pools may show profits. Cross-compliance between areas, however, require that profits from pools first be used to offset losses in quota pools in other area associations before being distributed to producers. Cross-compliance allows for the aggregation of peanuts across all regions shown in figure 2.

9. The Food and Drug Administration definition of peanut butter requires that the product be a minimum of 90% peanuts by weight. Salt, sugar, and stabilzers may be added. Peanut butter may be thinned with peanut oil. Peanut butter, however, must maintain a fat content less than 55 percent.

10. Planted acreage, not total production, was restricted. Thus, a high support price presented an incentive for producers to intensify production on each acre. This phenomenon as related to tobacco allotments was discussed in Foster and Babcock (1993).

11. See "Peanut Price Support Program," hearing before the Subcommittee on Specialty Crops and Natural Resources of the Committee on Agriculture of the U.S. House of Representatives.

12. These growers produce primarily additional peanuts, with little or no quota peanut production. They own little or no quota and typically live in counties with very small quota allotments.

13. The conversion is:

$$\begin{pmatrix}\text{tariff on raw}\\ \text{inshell peanuts}\end{pmatrix} = \begin{pmatrix}\text{tariff on}\\ \text{peanut butter}\end{pmatrix}(1.89).$$

14. Two previous studies were conducted by the USDA Economic Research Service (March 1994) and Carley and Fletcher (1993). The USDA report expected no imports beyond the minimum access levels. Further, because they assumed a continuation of ballooning peanut butter imports without GATT, they found GATT to be a boon for U.S. peanut producers. Carley and Fletcher estimated substantial peanut imports beyond the minimum access level. Their study was completed, however, before the official tariff rates were known and the development of the agreement on peanut butter.

Rucker, Thurman, and Borges predicted peanut imports equivalent to the minimum access levels. Asserting that political pressure would have forced some limitation to peanut butter imports without GATT, they assumed a zero net gain to producers from the peanut butter agreement. They estimated annual losses to domestic peanut producers of $10 to $18 million, approximately 1 cent per pound of domestic quota.