The Peanut Program and Its Effects

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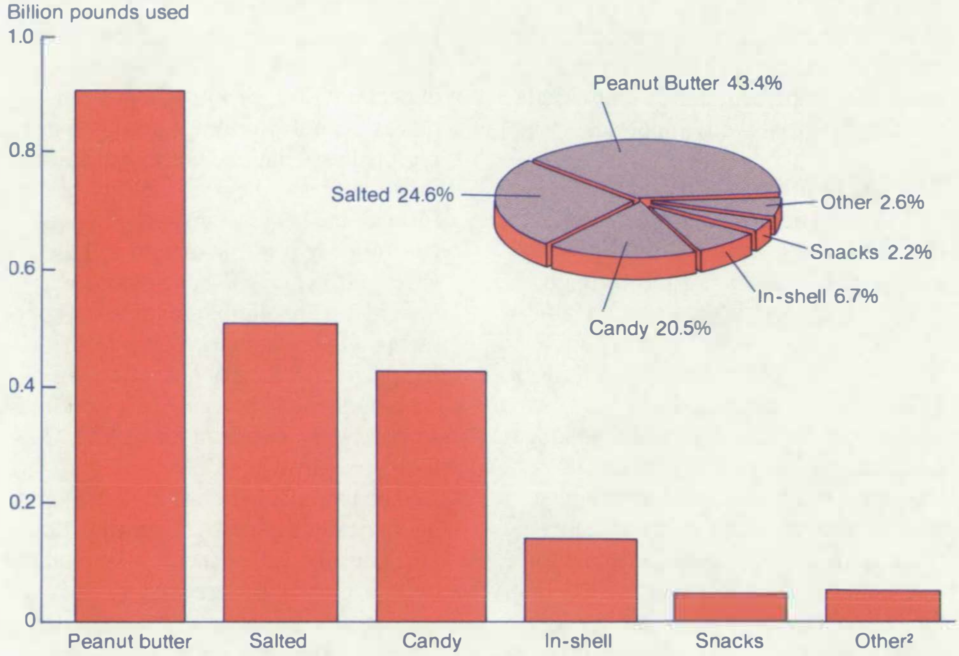
The United States is the world's third largest producer of peanuts, and Americans eat a lot of them, about 8.5 pounds per person annually. Peanut butter is a national favorite, accounting for more than 40 percent of the peanuts we eat *(figure 1)*. Peanuts are also an important ingredient in America's three most popular candies, which are Snickers, Reeses Peanut Butter Cups, and Peanut M&M's according to *Candy Marketer* magazine. As consumers, we are accustomed to a steady, wholesome supply of peanuts and peanut products at reasonable prices. Yet, most of us are probably unaware that the supply and price of peanuts have been affected by Government programs for more than 50 years.

The Federal peanut program supports the price received by farmers and raises the prices consumers pay for peanuts and peanut products. The program does these things without large Government outlays, using quotas and two-tiered pricing instead.

Figure 1. Peanut Butter Is an American Favorite[1]



[1]Peanut use in primary products, marketing year 1986/87 (August 1-July 31), in-shell basis. [2]Includes grated or granulated peanuts and peanut flour.

History of the Peanut Program

Peanuts have been under voluntary or mandatory programs since April 1934. A variety of programs operated in the 1930's and 1940's. During this time, the basic components of the post-World War II peanut programs appeared. For instance, in 1934 Congress designated peanuts, along with several other crops, as basic commodities requiring price support. Current law designates corn, cotton, peanuts, rice, tobacco, and wheat as basic commodities. Regional growers' associations were organized in 1937 to serve as agents for the Commodity Credit Corporation (CCC), the Federal organization that provides funding for price and income support programs. In 1941, three important program provisions were established. Price supports were tied to parity, an equity concept based on the idea that an agricultural commodity should have the same purchasing power it had in 1910-14. Marketing quotas (which limit the quantity producers may sell) were implemented, and a referendum was established to allow growers to periodically vote on the program's continuation.

From 1949 to 1977, the peanut program consisted of mandatory acreage allotments (which limit the acres that may be planted to peanuts) and marketing quotas, with the minimum price support set at 75 percent of parity and ranging as high as 90 percent. In the Food and Agricultural Act of 1977, the parity concept was dropped, and a two-tiered price support system was established. The new system, which remains in use, distinguished between "quota peanuts" and "additional peanuts." Quota peanuts were marketed under a national quota and used for domestic food products and seed. Sales of additional peanuts were restricted to exports or crushing for oil and meal. Higher price support loan rates were offered to producers for quota peanuts, while additional peanuts received a lower loan rate. The Agriculture and Food Act of 1981 eliminated acreage allotments and gradually reduced the national marketing quota to 1.1 million tons in 1985.

The domestic peanut price support program has been protected since 1953

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by a federally set annual import quota of about 1,000 tons, which is quite small compared with the marketing quota. In 1980, when a drought reduced domestic production 42 percent from year-earlier levels, the import limitation was eased and 200,000 tons were imported.

The Current Peanut Program

The current peanut program continues the two-tiered price support program for quota and additional peanuts through 1990. The program became mandatory after a January 1986 referendum in which peanut growers approved it for the 1986-90 marketing years.

Because acreage allotments no longer exist, anyone may grow peanuts. However, only those producers with a share of the national marketing quota (their farm quota) may sell peanuts for domestic food and related uses. By law, the national quota must be set at a level equal to domestic food, seed, and related uses, but not less than 1.1 million tons. The 1988 quota is 1.402 million tons.

The Food Security Act of 1985 apportioned the 1986 national quota among States based on their 1985 allocations. Individual farm quotas were then granted to farms that had a quota in 1985. Growers can acquire quotas two other ways. They may buy or lease another owner's quota, or they can establish a history of producing and marketing additional peanuts. When a State's quota is increased, farmers who grew and marketed additional peanuts in 2 of the preceding 3 years are entitled to a share of the increase.

Peanut prices are supported by offering loans to growers through the regional growers' associations. This means that producers receive loans at the price support rates in effect for quota and additional peanuts. To get a loan, a grower places peanuts in storage arranged by the regional association. Once this is done, the grower no longer has control of them. Instead, the peanuts are part of a pool controlled by the association and the CCC. Growers who have placed peanuts under loan are eligible for dividend payments if association revenues from selling peanuts in the pool exceed costs of running the loan program. Losses are absorbed by the Government as a CCC budget expense.

The national loan rate for 1988-crop quota peanuts is $615.27 per ton. Support rates for 1987-90 crops are required by law to equal the preceding year's rate adjusted for increases in the estimated costs of production, except those for land, during the previous year. Increases are limited to 6 percent. The quota support rate was increased for 1988 because the 1987 cost of producing peanuts rose above 1986 levels.

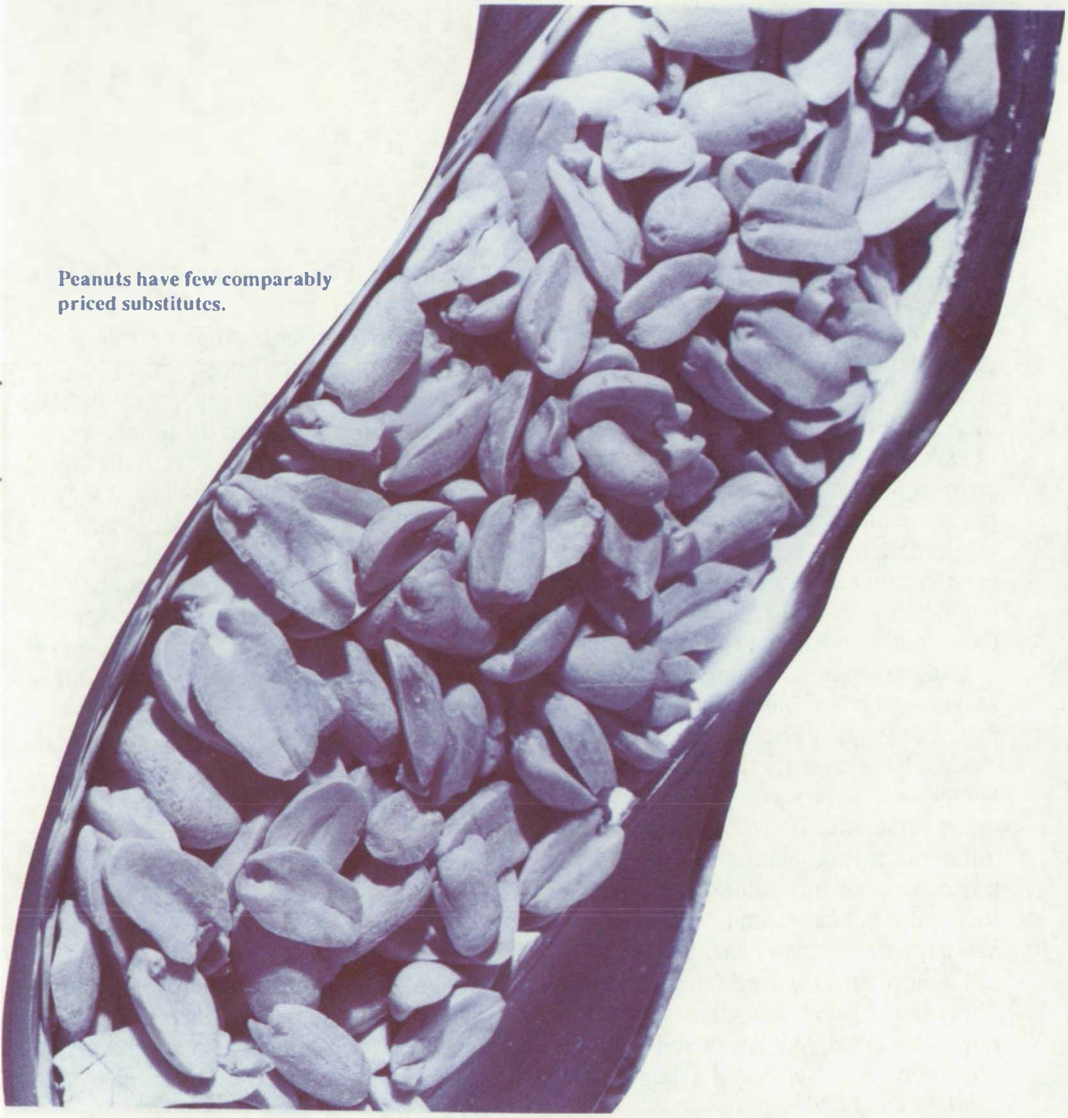
The support rate for 1988-crop additional peanuts is $149.75 per ton. This rate is set to ensure no loss to the CCC from the sale or disposal of these peanuts placed in the loan pools. The rate takes into account the demand for peanut oil and meal, the expected prices of other vegetable oils and protein meals, and the demand for peanuts for export.

Additional peanuts become available for domestic food use if they are "bought back" after being put under CCC loan. The price of these buy-backs must cover all Government costs and cannot be less than the quota loan rate. This program provision is valuable because it provides a supplemental source of peanuts should the quota supply be inadequate. Also, these sales generate revenues to offset operating costs of the peanut program.

The peanut program is administered by three regional growers' associations, which serve as agents for the CCC. These associations keep records of quota and additional peanut marketings, arrange warehousing for CCC loan peanuts, and operate the price support loan program.

Each year's quota and quota support rate combination, however, does not necessarily correspond to a quantity and price that domestic peanut buyers desire. If the quota support rate is higher than the price that domestic processors are willing to pay, some quota peanuts will go under loan at CCC's expense, and the quantity of peanuts consumed will be below the quota level. On the other hand, if the selling price for peanuts is above the quota support rate, there will be no incentive for producers to put quota peanuts under loan. Such has been the case in recent years.

Annual net CCC farm-related expenditures for the peanut program averaged $30 million in the 1960's, $61 million in the 1970's, and $10 million during 1982-86. Under the current program, the costs to taxpayers should be minimal because quotas now are set to equal expected domestic food and related demand. Furthermore, the loan rate for additional



Peanuts have few comparably priced substitutes.

peanuts is substantially below the market price. It is also below the current crush value. This means that few peanuts should go under loan and that CCC should be able to dispose of acquired peanuts at no loss.

However, the peanut program could cost the Government, taxpayers that is, substantially more money if the national marketing quota was much larger than what processors would want to buy at the quota loan rate. Growers would then place large quantities of quota peanuts under loan, and the Government would be obligated to buy the peanuts at the quota loan rate.

How the Peanut Program Affects Consumers

In supporting the price farmers receive, the peanut program raises the price consumers pay. In the same vein, by imposing marketing quotas, the program reduces the supply of peanuts available to consumers.

The quota loan rate puts a floor under the price peanuts can be sold for in the domestic market. It is difficult to say what peanut prices would be without the program because the program has existed for so long. We do know that in 1986, when the quota loan rate was $607 per ton, it cost about $420 to produce a ton of peanuts. This reflects the break-even, long-run average price necessary for growers to cover all costs of production and, thereby, continue to grow a crop. Therefore, a free market price would be closer to $420 per ton than $607. However, even this cost estimate may be questioned because farmers have adjusted their production practices and marketing strategies in response to the constraints and opportunities provided by the peanut program. Furthermore, a free market system would entail shifts in the location of production, which is now determined largely by the quota system.

The program reduces consumer purchases by limiting supply and, therefore, raising prices. This in turn, leads to smaller quantities demanded. But the national quota is not an absolute limit. Supply can be augmented through purchases of additional peanuts that had been placed under loan. And in years of extremely tight supply, such as the 1980/81 marketing year, the restrictions on imports may be eased.

Although a lower free market price would increase consumption, the size of the increase would be modest compared with the current level of consumption. This is because consumer demand for peanuts and peanut products, like the demand for many food products, is relatively insensitive to price changes. It has been estimated that a 10-percent decrease in peanut prices would increase total consumption just 2.3 percent. In terms of 1986/87 consumption levels, a 10-percent decrease in price would have added about 48 million pounds to the 2,073 million pounds consumed that year. Yet how consumers respond to price changes varies among peanut products. For example, peanut candy demand appears to be more price sensitive than peanut butter demand.

However, in general, peanut demand is relatively insensitive to changes in prices because peanuts, and especially peanut butter, have few good and comparably priced substitutes. Other nuts, such as almonds and cashews, are more expensive, and none of them make a good substitute for the peanut butter in a peanut butter and jelly sandwich.

Another reason for the limited response to price changes is the fact that peanuts and peanut products generally account for a relatively small portion of a consumer's budget. That is, spending on peanuts is small compared with spending on many other foods and consumer products. Buyers are less likely to adjust their spending on commodities that are considered small purchases.

How the Program Affects Processors

Peanut processors are the middlemen between growers and consumers. Their livelihood depends on a reliable supply of raw peanuts and a predictable demand for processed peanuts and peanut products. Although the domestic marketing quota attempts to match supply and demand, bad weather can lead to shortages and higher prices that can curb demand. Bad weather cannot be anticipated when setting the quota, so in years of low yields processors have to pay more than the minimum quota loan rate to obtain peanuts. Processors then have to either absorb these costs, resulting in narrower profit margins, or pass the increased price on to consumers.

Although consumers are relatively insensitive to price changes, they do respond to higher prices by reducing purchases. This is nearly the same situation that other food processors and manufacturers sometimes find themselves in. A difference is that shelling firms and processors who buy additional peanuts for export, but later cannot sell them abroad, are subject to penalties if they sell their product in the domestic market. This is a risk other industries do not face. Even with normal yields, unanticipated growth in consumer demand may lead to shortages and higher prices.

The Peanut Program and Producers

The Federal peanut program is intended to support the price farmers receive and thus improve their incomes. Farmers strongly support the program even though it restricts their activities by limiting the quantity of peanuts that may be marketed for domestic food, seed, and related uses.

Farmers benefit from the peanut program because prices are higher than they would be without it. The quota support rate is currently higher than the total cost of producing peanuts. Program benefits accrue to quota holders whether or not they produce peanuts, because farm quotas may be rented to other growers. Quota rents vary widely among States, but they average about $125 per ton in the Southeast.

Most other commodity programs support the price of agricultural products through a system of loans and deficiency payments that are underwritten by U.S. taxpayers. With peanuts, however, very little support is derived from Government outlays. Instead, consumers support the program by paying higher prices. ■