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PEANUT PROGRAM

Changes Are Needed to Make the Program Responsive to Market Forces

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here to discuss the findings of our recent report on the U.S. Department of Agriculture's (USDA) peanut program.[1] In response to a request from Representative Charles E. Schumer, we (1) compared and contrasted the agricultural and economic conditions that existed when the program was created in the 1930s with current conditions, (2) assessed the impact of the program on producers, consumers, the government, and international trade, and (3) identified changes needed in the program. USDA administers the peanut program to control the supply of U.S. peanuts and to guarantee producers a minimum price for their crops. Such programs have become increasingly vulnerable to criticism because of their costs and impact on trade negotiations.

In summary, 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 massive changes since the 1930s: Most importantly, the numbers of peanut farms and producers have decreased and the sizes of the remaining farms have increased. By 1991, fewer than one-fourth of all peanut producers held over four-fifths of the available quota pounds. Moreover, because the yearly quota support price since 1982 has been well above production costs, quota peanut producers have had an opportunity to receive, on average, a 51-percent minimum net return after costs as calculated by USDA to set the quota support price. Thus, the peanut program has provided substantial benefits to the relatively small number of producers that hold most of the quota. Furthermore, owners of more than one-half of the quota pounds--who do not grow peanuts themselves with that quota--benefit from the program because they 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.[2] Consequently, economic studies show that U.S. consumers 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 high cost of the peanut products that it buys under various food assistance programs. Lastly, the program may affect international trade, primarily by increasing the volume of U.S. peanuts available for

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

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

export. This increase should cause a decline in the prices paid for peanuts by foreign consumers.

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 consumers--we recommended in our February 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) reexamine the method of assigning quota because a large volume of quota is owned by persons who do not grow peanuts with that quota.

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. 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-tiered system that sets minimum support prices for quota and additional peanuts. In 1991, the quota support price was $643 per ton and the additional support price was $150 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 Agricultural Stabilization and Conservation Service 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 SIGNIFICANTLY 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 PEANUT PROGRAM PROVIDES HIGH RETURNS TO A SMALL NUMBER OF PRODUCERS

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. The peanut program is particularly generous to these producers because it sets quota support prices at levels that virtually guarantee high net returns after costs. From 1982 through 1992, the annual quota support price averaged $697 per ton, while the estimated cost of producing peanuts (which includes variable and fixed cash expenses plus allocations for capital equipment replacement and unpaid labor) averaged $463 per ton--a difference of $234 per ton, or an average minimum net return after costs of 51 percent. We should point out, however, that this average net return 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 production costs incurred by producers.

Moreover, 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. From 1985 through 1990, CCC paid producers over $63 million for these losses (averaging $10.5 million a year). Also, peanut producers--mainly those with additional peanuts--who place their peanuts under loan may receive dividends when CCC sells their peanuts for more than the support prices. From 1981 through 1990, CCC paid producers $645 million in dividends (averaging $64.5 million a year).

QUOTA OWNERS WHO DO NOT GROW PEANUTS RECEIVE PROGRAM BENEFITS

The peanut program also supports 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 alone during 1990, sales of quota were estimated at $2.3 million. As for rentals, in 1988, 68 percent of all quota owners, 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 in 1991 could have paid $208 million for the privilege of using someone else's quota.[3] Although quota sales and rentals provide income to persons who do not produce peanuts with that quota, this program provision prevents quota from being transferred 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. CONSUMERS HUNDREDS OF MILLIONS OF DOLLARS EACH YEAR

Under the peanut program, producers' incomes are supported primarily through transfers, that is, a "tax" that consumers 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 consumers' 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 social welfare loss that reflects inefficiencies in the program's use or allocation of resources. We should point out that consumers' costs are measured on a 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) average costs resulting from the peanut program were substantially reduced by legislative changes in 1977 and 1981, which transferred most of the program's costs to U.S. consumers. Nevertheless, from 1986 through 1990, USDA still incurred average costs of $34.4 million a year: $14.5 million to cover CCC loan losses, $4.5 million for program administration, $11.0 million for disaster transfer payments, and $4.4 million to help producers and exporters develop foreign markets for peanuts. In addition to these USDA costs, which are for the most part directly related to the peanut program, 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.

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[3]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.

THE PEANUT PROGRAM MAY ALSO AFFECT INTERNATIONAL TRADE

Given the volume of U.S. peanuts exported, the peanut program may affect the international market as well as the domestic market. The magnitude of the program's effect on international trade is unclear, however, because there is uncertainty as to the extent that (1) the program results in additional U.S. exports, (2) the quantity of U.S. 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 58 years ago no longer exist. Most peanuts in the United States today are produced by large agribusinesses rather than by the small family farms that dominated agriculture in the 1930s. Moreover, in view of ongoing and future negotiations concerning changes in agricultural policies, domestic policies have become increasingly vulnerable to criticism because of their contribution to budgetary expenditures by taxpayers, costs to consumers, and trade disputes. As agreements are reached among the major agricultural trading nations, government supports such as those associated with the peanut program are likely to change. Accordingly, the Congress needs to take a closer look at the peanut program and make it more responsive to market forces.

In our February 1993 report, we recommended that the Congress restructure the peanut program to make it more responsive to market forces. As part of this 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, the Congress, with assistance from USDA, should consider such factors as (1) producers' recent expectations concerning the life of the peanut program and (2) the useful life of capital investments in equipment specifically purchased for peanut production.

We also recommended in our report that the Congress take the following actions:

-- 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.

-- Reexamine the method of assigning quota in view of the fact that a large volume of quota is owned by persons who do not grow peanuts with that quota. If the poundage quota system is continued, the Congress should allow quota to be transferred to producers outside the boundaries of counties where the quota is currently assigned in order to promote competition among the more efficient peanut producers.

-- Amend the peanut legislation to allow the quota support price to decrease as well as increase each year as production costs decrease and increase.

-- Permit government agencies--such as USDA, which procures peanuts and peanut products for various food assistance programs--to purchase domestic peanuts at the world price rather than at the higher quota support price.

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In commenting on a draft of our report, USDA concurred with our recommendations but did not agree with all of our interpretations of data and conclusions. In particular, USDA questioned our estimate of the value of quota rentals and our definition of consumer. While we made minor revisions to our final report to address USDA's comments, none of the revisions changed the message of the report or our conclusions or recommendations.

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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