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**United States General Accounting Office**
**Washington, DC 20548**

September 26, 2001

The Honorable Christopher Shays
House of Representatives

The Honorable Paul E. Kanjorski
House of Representatives

Subject:    Peanut Program: Potential Effects of Proposed Farm Bill on Producers,
            Consumers, Government, and Peanut Imports and Exports

The current federal peanut program, administered by the U.S. Department of
Agriculture (USDA), is designed to support producers' incomes while ensuring an
ample supply of domestically produced peanuts. To accomplish these goals, the
program controls the domestic supply of peanuts and guarantees producers a
minimum price for their crops. This price substantially exceeds the price for peanuts
in world markets. The program uses two mechanisms to control the domestic supply
of peanuts: (1) a national quota on the number of pounds that can be sold for edible
consumption domestically and (2) import restrictions. While anyone can grow
peanuts, only producers holding quota, either through ownership or rental of
farmland, may sell their peanuts domestically, as "quota" peanuts. Generally, all other
production, referred to as "additional" peanuts, must be exported or crushed for oil
and meal. The program protects producers' incomes through a two-tiered system
that sets minimum support prices for quota and for additional peanuts. Producers of
quota peanuts are guaranteed a support price of $610 per-ton, called the "quota loan
rate." Producers of additional peanuts are guaranteed a lower support price of $132
per-ton, called the "additional loan rate." Producers may sell their peanuts at or
above these loan rates, or they may place their peanuts under loan with USDA and
have the government sell them. This program, while long-standing, has been
criticized by GAO and others because, among other things, it provides substantial
benefits to a relatively small number of producers who hold most of the quota,
generally restricts nonquota holders from producing peanuts for the U.S. domestic
market, and increases consumers' cost.[1] The program is, however, designed to

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

operate generally at "no-net cost" to the government. Additionally, since the $610 per-ton quota loan rate is substantially higher than the estimated world price—$321 to $462 per-ton from 1996 through 2000—the quota loan rate provides incentives for exporting countries to maximize the quantity of peanuts the U.S. allows to be imported under recent trade agreements. These imports could displace domestically produced peanuts that otherwise would enter U.S. food marketing channels.

To address these and other concerns about the peanut program, you asked that we review its structure and operations under the 1996 Farm Bill, and its impacts on producers, consumers, the federal government, and imports and exports of peanuts. However, on July 27, 2001, before we completed our review, the House Committee on Agriculture approved the 2002 Farm Bill, for 2002 through 2011 (the Farm Security Act of 2001, H.R. 2646). If enacted, this bill would fundamentally alter the peanut program's structure by, among other things, eliminating the national poundage quota and allowing peanut buyers to purchase domestically produced peanuts at the prevailing market price. Because of your interest in making the program more market-oriented, you subsequently asked us to report on the potential impact of this bill on producers, consumers, the federal government, and imports and exports of peanuts.

**Major Changes to the Peanut Program Under the House Committee on Agriculture's Bill**

Beginning in 2002, and for the next 10 years, the bill passed by the House Committee on Agriculture would eliminate the national poundage quota and replace the current two-tiered price system with several new support mechanisms for peanut quota owners and producers. These changes would essentially bring the peanut program in line with other commodity programs. The bill would establish the following new types of support for peanut producers:

> A **"counter-cyclical" payment**. This payment would provide financial assistance to producers when prices are below a legislatively established target price. Peanut producers would receive a payment based on the difference between a USDA-calculated price and a $480 target price—known as a counter-cyclical payment.[2] The payment amount would be calculated on 85 percent of a producer's peanut acres and the average yield for crop years 1998 through 2001. A producer's production during these years would be the producer's base production. Since the payment would be calculated using historic yield and acreage, producers would receive it even if they choose not to plant peanuts. According to the Congressional Budget Office (CBO), the counter-cyclical payments would cost an estimated $1.24 billion in government expenditures over the life of the farm bill.

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[2] The USDA-calculated price would be equal to the higher of (1) the 12-month national average market price for peanuts plus the fixed $36 per-ton decoupled payment or (2) the marketing assistance loan rate of $350 per-ton plus the fixed $36 per-ton decoupled payment.

**A "fixed, decoupled" payment**.  This payment would provide peanut producers with compensation similar to the production flexibility contract payments provided for other crops, such as cotton and wheat, in the 1996 Farm Bill (Federal Agriculture Improvement and Reform Act of 1996).[3]  Producers with base production would receive support—known as a fixed, decoupled payment—in the amount of $36 per-ton on the base production.  This support is called "decoupled" because it would be paid whether or not a producer chooses to grow peanuts and regardless of market prices.  Since the payment would be calculated using historic yield and acreage, producers would receive it even if they choose not to plant peanuts.  According to CBO, the fixed, decoupled payments would cost an estimated $0.63 billion over the life of the farm bill.

**A marketing assistance loan**.  This loan would provide producers with interim financial assistance at harvest, when prices are usually lower than at other times of the marketing year.  Producers could pledge their stored peanuts as collateral for up to 9 months at a loan rate of $350 per-ton.  Producers would then repay the loan at a rate that is the lesser of (1) $350 per-ton plus interest or (2) a USDA-calculated loan repayment rate, which was not specified in the bill.[4]  If producers were to redeem the loan at less than the loan amount, they would realize a marketing loan gain.  Alternatively, producers could receive an amount equivalent to the marketing assistance loan gain, referred to as a loan deficiency payment, by agreeing to forgo a loan.  Producers would also be able to forfeit their peanuts to the government as payment for their loan, regardless of the market value of peanuts at the time.  According to CBO, the marketing loan payments will cost an estimated $0.44 billion over the life of the farm bill.

**A "buy-out" payment**.  Quota owners would receive compensation for the lost asset value of their quota.  This "buy-out" payment would be made in five annual installments of $200 per-ton during fiscal years 2002 through 2006.  The payment would be based on the quota owners' 2001 quota.  According to CBO, payments would total $1.18 billion to quota owners for the 5-year period from 2002 through 2006.

All peanut producers would be eligible to receive a marketing assistance loan or a loan deficiency payment.  However, only those who produced peanuts during crop years 1998 through 2001 (the base production period)[5] would be eligible to receive counter-cyclical and fixed, decoupled payments.

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[3] These payments are also known as AMTA payments in reference to the Agricultural Market Transition Act, which is title I of the 1996 Farm Bill and the section that established production flexibility contracts.

[4] USDA is directed to set the repayment rate to minimize loan forfeiture, government-owned stocks, and storage costs as well as to allow free and competitive marketing of U.S.-produced peanuts in both domestic and international markets.  The method for calculating this repayment rate is not specified.

[5] If a producer had zero or low yield (less than 65% because of disaster) during the base production period of 1998-2001, a substitute yield, equal to 65 percent of the county yield, would be used.

## All Peanut Producers Would Benefit Under the House Committee on Agriculture's Bill

New and existing peanut producers would benefit from the support mechanisms contained in the House Committee bill.  Table 1 shows the estimated amounts producers would receive from peanut sales and government support under the current peanut program compared with the House Committee bill.  Because the peanut provisions of the House Committee bill would essentially establish minimum guaranteed prices—a target price of $480 per-ton for base production and a $350 per-ton marketing assistance loan for all other production—the amounts shown in the table generally represent the minimum amount producers could expect to receive for their production.

The table assumes that a peanut producer has 100 acres under production, a yield of 2,500 pounds per acre, and receives a market price of $325 per-ton.  These production and yield assumptions are based on national averages contained in USDA's 1997 Census of Agriculture.  The $325 market price is an estimate based on conversations with shellers and area marketing associations in August 2001.

**Table 1: Minimum Estimated Amounts Producer Would Receive under the Current and Proposed Peanut Programs, on 100 Acres of Production**

| Types of program supports | 100 percent quota producer with base production | 100 percent additional producer with base production | New producer without base production |
|---|---|---|---|
| **Current program** | | | |
| Quota support price | $76,250[a] | Not applicable | Not applicable |
| Additional support price | Not applicable | $16,500[b] | $16,500[b] |
| **Total amount** | **$76,250** | **$16,500** | **$16,500** |
| **Proposed program** | | | |
| Market revenue | $40,625[c] | $40,625[c] | $40,625[c] |
| Counter-cyclical | $9,988[d] | $9,988[d] | Not applicable |
| Fixed, decoupled | $3,825[e] | $3,825[e] | Not applicable |
| Marketing assistance loan gain | $3,125[f] | $3,125[f] | $3,125[f] |
| Lost asset value | $25,000[g] | Not applicable | Not applicable |
| **Total amount** | **$82,563** | **$57,563** | **$43,750** |
| **Difference between current and proposed program** | **$6,313** | **$41,063** | **$27,250** |

Note:  Under the proposed program, producers with base production could also receive support as a new producer if they expand production.

[a]Represents the product of the $610 per-ton quota support price times 1.25 tons (2,500 pounds per acre) times 100 acres.  Because this is considered a "no-net cost" program to the government, this is paid by the consumer.

[b]Represents the minimum amount an additional or new peanut producer would receive, calculated as the product of $132 per-ton additional loan rate times 1.25 tons (2,500 pounds per acre) times 100 acres.  However, these producers may receive higher amounts if they sell their peanuts for export rather than placing them under loan.

[c]Represents the $325 per-ton market price times 1.25 tons (2,500 pounds per acre) times 100 acres.

[d]Represents the $480 per-ton target price minus the $350 loan rate and the $36 per-ton fixed, decoupled payment times 1.25 tons (2,500 pounds per acre) times 100 acres times 85 percent.  Producers would receive this payment even if they choose not to plant peanuts since it is calculated using historic yield and acreage.

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[e]Represents the $36 per-ton fixed, decoupled payment times 1.25 tons (2,500 pounds per acre) times 100 acres times 85 percent. Producers would receive this payment even if they choose not to plant peanuts since it is calculated using historic yield and acreage.

[f]Represents either a marketing loan gain or a loan deficiency payment. It is the product of the difference between the $350 per-ton marketing assistance loan and the $325 per-ton market price times 1.25 tons (2,500 pounds per acre) times 100 acres. If the market price decreases, these government support costs would increase to make up the difference between the lower market price and the marketing assistance loan rate.

[g]Represents the product of the $200 per-ton compensation for the lost asset value of quota times 1.25 tons (2,500 pounds per acre) times 100 acres. This "buy-out" payment is only paid during fiscal years 2002-2006.

Source: GAO's analysis of USDA's data and the House Committee bill.

As the table shows, most of the government's payments under the House Committee bill would go to quota peanut producers with base production, followed by payments to additional peanut producers with base production. This is because quota holders and additional producers would be eligible to receive the counter-cyclical payment, the fixed, decoupled payment, and a marketing assistance loan payment. In addition, quota owners would be compensated for the value of their lost asset.

Nevertheless, current additional and new peanut producers potentially gain the most under the House Committee bill because they could (1) market their peanuts in the domestic edible market and (2) receive a minimum guaranteed price of $350 per-ton under the marketing assistance loan. For example, as the table shows, producers of additional peanuts with base production on 100 acres would have been guaranteed $16,500 per year under the existing program, compared with $57,563 under the proposed bill.

Peanut production would be expected to increase to the extent that the House Committee bill would provide increased returns to producers that are higher than the returns they would have received under the old program or that are higher relative to other commodities that they produce. If production increases, it is likely to cause market prices for peanuts to fall and government payments to increase.

## Consumers Should Pay Less for Peanuts, but the Government Would Pay More

Under the House Committee on Agriculture's bill, the burden of supporting peanut producers would shift from consumers to the government. Consumers—defined as shellers, manufacturers, and the general public—should pay less for domestically produced peanuts because the proposed legislation would eliminate the $610 quota support price, which is substantially higher than the estimated $321 to $462 per-ton world price over the past 5 years.

While consumers should benefit under the House Committee bill, government costs would increase. For example, the current peanut program is intended to operate with no net cost to the government, while the House Committee bill would provide direct government support payments to peanut producers. CBO estimates that these direct support payments would cost $3.5 billion over the next 10 years. This cost estimate includes counter-cyclical and fixed, decoupled payments, marketing assistance loans,

and the buy-out payments for the lost asset value of the quota.  To the extent to which producers expand production beyond CBO's estimates, increases in government costs could be greater than estimated.

**Proposed Program Provisions May be Considered Trade Distorting but Should Decrease Incentives for Imports**

Several of the new support mechanisms contained in the House Committee bill may be identified as "trade distorting"—altering free trade of peanuts—under the 1994 Uruguay Round Agreement on Agriculture.[6]  For example, gains resulting from loan deficiency payments and marketing assistance loans for other crops, such as corn and cotton, have previously been identified as trade distorting by USDA.  Our obligation under the Uruguay Round Agreement is to hold the amount of such U.S. trade-distorting government support below $19.1 billion annually by 2000.[7]  In 1998, USDA notified the World Trade Organization that 12 commodities received support identified as trade distorting, but the amount remained within the cap.  Negotiations are under way, however, to further reduce trade-distorting government support.

Although some of the new support mechanisms may be considered trade distorting, to the extent to which they lead to lower domestic peanut prices, these supports should reduce incentives for imports, primarily from Argentina and Mexico.  According to peanut shellers, domestically produced peanuts would be purchased at prices that are less than the current $610 per-ton quota loan rate.  The shellers also hope that a lower U.S. peanut price will help them increase exports.

**Agency Comments**

We received oral comments on a draft of this report from USDA's Farm Service Agency, the Foreign Agricultural Service and the Economic Research Service and the U.S. Trade Representative.  They generally agreed with the substance of the report and provided technical and clarifying comments, which we incorporated as appropriate.  FSA officials also informed us there are certain items in the House Committee bill that will require technical clarification.  USDA has sent a letter to the House Agriculture Committee requesting guidance and clarification of these issues and was awaiting a response from the Committee as of the date of this letter.

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[6] Under the 1994 Uruguay Round Agreement on Agriculture, which established the World Trade Organization, all member countries are required to reduce their trade-distorting domestic support for agriculture—as measured by an aggregate measure of government support.  Components of the aggregate measure include (1) non-exempt direct government payments to producers, (2) production input subsidies (such as irrigation water), (3) the estimated value of revenue transferred from consumers to producers as a result of domestic policies that distort market prices, and (4) interest subsidies on commodity loan programs.

[7] Not all support is considered trade distorting.  For example, production flexibility contract payments provided for other crops, such as corn and cotton, have previously been identified as minimally trade distorting—meaning it doesn't count toward the $19.1 billion cap—by USDA since they are not tied to production or market prices.

**Scope and Methodology**

In order to respond to your request, we obtained and analyzed the Farm Security Act of 2001, testimony provided by producer and industry officials to the House Committee on Agriculture in June 2001 and the Senate Committee on Agriculture, Nutrition, and Forestry in July 2001, the World Trade Organization and the USDA Economic Research Service reports on domestic supports, the USDA's 1997 Census of Agriculture, and other information pertaining to domestic and international peanut production. We also interviewed representatives from USDA, peanut area marketing associations, peanut shellers, and a product manufacturer concerning the bill's provisions and potential impacts. To estimate the minimum amount of producer receipts, we reviewed the applicable provisions of the House Committee bill, obtained and examined data on peanut production, yield, and price.

We conducted our work from July through August 2001, in accordance with generally accepted government auditing standards

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We will provide copies of this report to the congressional committees with jurisdiction over farm programs; the Honorable Ann M. Veneman, Secretary of Agriculture; Ambassador Robert B. Zoellick, U.S. Trade Representative; and other interested parties. The letter will also be available on GAO's home page at http://www.gao.gov.

If you have any questions about this letter, please contact me at (202) 512-3841 or Assistant Director Robert C. Summers at 404-679-1839. Other key contributors to this report were Carol Bray, Mary Denigan-Macauley, and John C. Smith.

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