

Peanuts: Responding to Opportunities and Challenges from an Intertwined Trade and Domestic Policies

Stanley M. Fletcher
National Center for Peanut Competitiveness
University of Georgia

*“If you do not take change by the hand,
Change will take you by the throat.”
Winston Churchill*

This quote from Winston Churchill adequately sums up the environment that peanut growers are experiencing – **CHANGE**. Whether they like it or not, the U.S. peanut policy is intertwined with the world trade policy. **WHY?** January 1, 1994 and January 1, 1995 are the dates for all peanut growers to remember. NAFTA was implemented on January 1, 1994 and the Uruguay Round of GATT (now WTO) was implemented on January 1, 1995.

Prior to the GATT and NAFTA trade agreements, the U.S. peanuts had Section 22 protecting its domestic supply management program coupled with a support price significantly above the world peanut price. The trade agreements eliminated Section 22 as one of the U.S. domestic farm policy instruments and replaced it with TRQs (tariff rate quotas) and a declining tariff schedule (Tables 1-3). The minimum access provisions provided at least 8-10 percent of the U.S. domestic peanut market to imports. The tariff schedules were set such that the declining tariff schedules provided adequate protection against additional imports during the 1990s and early 2000s. The reader is referred to Fletcher for a more detailed discussion on peanuts from a world perspective and the U.S. position.

While peanuts may be regarded as a minor crop on a national scale, peanuts are a key integral component of Southern agriculture and the Southern rural economy. For example, based on the U.S. Ag Census, peanuts provide the majority of agriculture income in many of the peanut producing counties in the South. In fact, many counties derive 50-70% of their agriculture

income from peanuts. The first level of value-added activity of peanuts involving shelling is performed in the local Southern communities. Many of the peanut product manufacturing facilities are located in the same local Southern communities. This provides jobs and additional economic activity to the Southern communities. The peanut infrastructure has developed in primarily three areas in the South. Approximately 60% of the production occurs in Georgia, Florida and Alabama. About 25% of the production occurs in Oklahoma, Texas and New Mexico. The remainder occurs in North Carolina and Virginia.

Given the importance of peanuts to the local Southern rural economy, the U.S. trade policy and domestic farm policy were coming to a crossroads. This had occurred during the recent Farm Bill debate. One group wanted to basically ignore the implications of the U.S. trade policy while the other group wanted to create a new domestic farm policy within the structure of the U.S. trade policy.

TRADE POLICY

The North America Free Trade Agreement (NAFTA) is a free trade agreement. This means that after a certain time period there will be **NO** barriers to trade between the U.S. and Mexico. In other words, by 2008 the tariff is 0% and free movement of peanuts between the U.S. and Mexico can occur (Table 1). However, sometime between 2003 and 2005, the tariff schedule for Mexico under NAFTA will become ineffective in keeping Mexican peanuts out of the U.S. What does being ineffective mean? Using the 2003 to 2005 tariffs in Table 1, the implied breakeven price for Mexican peanuts would be between \$386 per ton farmer stock peanut to \$452 per ton. Mexican peanuts can be purchased in this price range and imported into the U.S. After paying the tariff, those peanuts could still be less than the U.S. domestic peanut price. The peanut farmer has no incentive to accept a lower price since the government support

price would be higher which the producer can receive. Thus, the only constraint to Mexican peanut imports would be Mexico's production capacity. The U.S. government would be required to purchase the excess U.S. peanut production. Government cost would increase which would lead to a decrease in quota production allocation and an increase assessment to U.S. peanut quota producers to assure the peanut program is a no-net-cost program. Under this scenario, the U.S. peanut supply management program would become ineffective.

While shelled and in-shelled peanuts are covered under the trade agreements, many peanut food products are not included under the minimum access or tariff schedules. For example, the NAFTA agreement did not address any protection on peanut butter/paste while GATT/WTO did. Thus, Mexico can ship unlimited supplies of peanut butter/paste into the U.S. without any quantity controls. While science can identify the origins of raw peanuts, such capability is not available for processed peanut products such as peanut butter/paste, which could lead to potential transshipment issues. In the last couple of years, Mexico has started shipping peanut butter/paste into the U.S. and the volume is increasing (almost 5,000 metric tons in 2001). Many peanut food products such as peanut candy, cookies and confectionary items are not included in either trade agreement. An estimated 175,000 tons of farmer stock equivalent peanuts are entering the domestic market each year by means of these products (Cotton). This is over 10% of the domestic market. With these exceptions, peanut processing/manufacturing is slowly moving offshore to take advantage of these opportunities. Once this occurs, one cannot easily recapture the manufacturing capacity. One just has to look at the decline of the textile industry in the South to understand the potential outcome for peanuts.

While giving the rest of the world minimum access into our domestic market (Tables 2 and 3) seemed a way to protect the rest of the U.S. domestic peanut market, in reality, U.S.

competitors were given the opportunity to build up their infrastructure by utilizing the excess profits they made on their peanuts exported to the U.S. For example, based on U.S. Department of Commerce data for 2000, Argentina peanut imports into the U.S. had an average price of 36.8 cents per pound CIF for shelled peanuts. In contrast, the 1998-1999 U.S. average medium shelled runner price was 57.5 cents per pound FOB. Thus, Argentina peanut exporters received approximately 20 cents per pound extra profit. This is **SIGNIFICANT** and has allowed U.S. competitors to build up their infrastructure. Once infrastructure is built, our competitive position will diminish. To further illustrate the point, Figure 1 provides snapshots of the various segments of the Argentina peanut sector. Except for the tractor, U.S. peanut farmers would have thought Figure 1 illustrated various segments within the U.S. Those segments did not basically exist in Argentina before the trade agreements were implemented.

Figure 1. Argentina's Modern Technology in Peanut Production and Shelling



Table 1. U.S. ad valorem Tariffs for Shelled and Prepared Peanuts and Peanut Butter under NAFTA and GATT/WTO

NAFTA		GATT/WTO	
Year	Shelled and prepared peanuts	Year	Shelled & prepared and peanut butter
Base	123.1	Base	155.0
1994	120.0		
1995	116.9	1995	151.1
1996	113.9	1996	147.3
1997	110.8	1997	143.4
1998	107.7	1998	139.5
1999	104.6	1999	135.7
2000	93.0	2000	131.8
2001	81.4	2001	131.8
2002	69.8	2002	131.8
2003	58.1		
2004	46.5		
2005	34.9		
2006	23.3		
2007	11.6		
2008	0.0		

Source: Uruguay Round Agricultural Negotiation, United States of America, Revised Country Schedule and North America Free Trade Agreement.

Table 2. Minimum Access Import Levels for Edible Peanut under NAFTA and GATT/WTO

Year	Argentina	Mexico ^a	Other	Total
----- metric tons -----				
1995	26,341	3,478	4,052	33,871
1996	29,853	3,582	5,043	38,478
1997	33,364	3,690	6,034	43,088
1998	36,877	3,801	7,024	47,702
1999	40,388	3,915	8,015	52,318
2000	43,901	4,032	9,005	56,938
2001	43,901	4,153	9,005	57,059
2002	43,901	4,278	9,005	57,184

^a The import year starts April 1 for Mexico.

Source: Uruguay Round Agricultural Negotiation, United States of America, Revised Country Schedule and North America Free Trade Agreement.

Table 3. Minimum Access Import Levels for Peanut Butter under GATT/WTO

Year	Canada	Argentina	GSP		Total
			Countries	Others	
----- metric tons -----					
1995	14,500	3,650	750	250	19,150
1996	14,500	3,650	920	250	19,320
1997	14,500	3,650	1,090	250	19,490
1998	14,500	3,650	1,260	250	19,660
1999	14,500	3,650	1,430	250	19,830
2000	14,500	3,650	1,600	250	20,000
2001	14,500	3,650	1,600	250	20,000
2002	14,500	3,650	1,600	250	20,000

Source: Uruguay Round Agricultural Negotiation, United States of America, Revised Country Schedule.

The current WTO and FTAA (Free Trade Area of the Americas) negotiations created the environment of needed change. The FTAA agreement will bring the major peanut exporters (i.e., Argentina and Nicaragua) and potential peanut producer (Brazil) into direct competition with U.S. peanut producers. While the current WTO peanut tariff schedule is high enough to protect the U.S. market from being flooded by imports, the potential tariff schedules may not afford any protection to U.S. peanut producers. If one considers the Argentina prices discussed earlier, the tariff equivalent is approximately 66% ad valorem. The 2003 NAFTA tariff is below this value. If the agriculture negotiators took a midpoint between the WTO and NAFTA tariffs, that level may not afford any protection to the U.S. peanut producers with the FAIR Act peanut program in place.

On January 1, 2002, Argentina devalued their currency significantly. The Argentina peso was originally tied to the U.S. dollar on a 1 to 1 value. The new official rate was pegged at 1.4 pesos per U.S. dollar. The free market rate was allowed to move with the value starting at approximately 1.6 pesos per U.S. dollar. Recently, the free market rate has exceeded 3 pesos per U.S. dollar. A preliminary study (Revoredo and Fletcher) has shown that if the exchange rate was approximately 2 pesos per U.S. dollar that the current WTO tariff schedule may not be effective in protecting U.S. peanut producers.

DOMESTIC POLICY

The 1996 farm bill (FAIR Act) amended previous legislation to continue the peanut program of supply control and price supports through the 2002 crop. This program was the result of several modifications by previous farm bills designed to meet changing supply/demand conditions and minimize government cost. Three regional grower associations established in 1937, which act as marketing agents for the Commodity Credit Corporation, administer the loan

provisions. Handling, processing and quality control was coordinated by the Peanut Administrative Committee under USDA Marketing Agreement 146 (1965).

The major provisions of the FAIR Act peanut program were:

- # Supply was controlled through poundage quotas set annually by the Secretary of Agriculture at a level to meet U.S. edible and related uses.
- # The 1996 farm bill provided to all producers temporary seed quota that is allocated each year based upon the amount of acres planted.
- # The 1996 farm bill eliminated “undermarketings”. Nonproduced quota (undermarketing) was no longer allowed to be carried forward to future years. If a farmer is unable to produce their quota due to weather and other uncontrollable factors, the producer is allowed to fall transfer the nonproduced quota. A producer can do a disaster transfer of segregation 2's and 3's peanuts up to 25% of the farm's quota at 75% of the quota support price.
- # Peanut production above the farm's poundage quota was referred to as “additional”. These peanuts were produced and sold primarily in the export and crush markets. Some additional may also enter the U.S. edible market through the “buyback” provision. Farms without peanut quota may grow additional.
- # Price support was provided through a two-tiered price system. Quota peanuts were supported at a fixed rate of \$610 per ton (down from \$678 in 1995) for the life of the 1996 farm bill. The support price for additional was set by the Secretary to ensure the CCC incurs no losses in the additional's pool. The 2001 support price was \$132/ton for additional.
- # Quota may be sold or leased within the same county, unrestricted. Under the 1996 farm bill, a limited amount of quota may be sold or leased across county lines within the state. Spring

sale and lease was allowed in-state and capped at 40% of the county base quota level as of January 1, 1996. Fall transfer was unlimited within the state.

- # Quota would be reduced if not produced or “considered produced” in two of the three previous years.
- # The 1990 Budget Act initiated a marketing assessment beginning with the 1991 crop. Currently, the producer share is 0.65 percent while the first handler share is .55 percent.
- # Peanuts were a “no-net cost” program to the government under the 1996 farm bill. Producers face increased assessments in the years following program losses. Regulations on minimum resale prices and cross-compliance between the regional associations minimizes government cost exposure.

Keeping the FAIR Act’s peanut program or some similar version would have created significant government outlays in light of the trade policy, which would render the program politically impractical. Thus, some of the peanut grower leaders formed a coalition with the peanut shellers and manufacturers to devise a new peanut program that would fit within the political constraints and trade policy. The alternative peanut program eliminated the current supply management program and developed a framework similar to the program crops. This alternative peanut program became part of the 2002 Farm Bill.

The major provisions of the new peanut program in the 2002 Farm Bill are:

- # Quota system was eliminated with a buyout of 11 cents/lb to the quota holders over 5 years based on the quota holder’s 2001 quota.
- # A peanut base will be established based on the 1998-2001 peanut acreage and yield. The base is initially assigned to a historical peanut producer (a peanut producer during the 1998-2001 period). This producer must assign the base to a farm not later than March 31, 2003.

- # For 2002 crop year, historic peanut producers will receive a direct payment of 1.8 cents/lb on 85% of their base. For subsequent years, a producer with a farm having a peanut base will receive the direct payment of 1.8 cents/lb.
- # If the peanut market price drops below the difference of the target price of \$495/ton and the direct payment, a counter-cyclical payment will be made. For the 2002 crop year, historic peanut producers will receive the payment. For subsequent years, a producer with a farm having a peanut base will receive the payment.
- # Finally, a producer, independent of peanut base, will have a peanut marketing loan established at the level of \$355/ton.
- # The Peanut Administrative Committee was terminated. A Peanut Standards Board will be established to advise the Secretary in regards to the establishment of quality and handling standards for domestically produced peanuts and imported peanuts.

IMPLICATIONS

This new policy moves part of the potential budget outlays from being totally in the amber box as was the case with the old program to the green box. Furthermore, this policy change will alter the world peanut trade flows as well as the peanut imports into the U.S. under the minimum access procession.

How would this new peanut policy potentially alter the peanut trade flows? Reliability is the answer. While the U.S. sets the standard in peanut quality, consistent reliability was absent due to the structure of the old peanut program. Since the 1980s, the U.S. has experienced an abnormal number of droughts, which have impacted the U.S. peanut production. When a peanut production shortfall occurs, the domestic market is satisfied first with the export market being the residual market. The export market price was significantly lower than the domestic market

price for producers. Secondly, the producer wanted to protect their peanut quota allocation by delivering quota first and then any additional, if any, second. Now, the export market can compete with the domestic market on equal footing for U.S. peanuts.

The new peanut policy will create inter- and intra-regional changes in peanut production. Furthermore, potential cropping pattern shifts will probably occur. Peanut production quality and cost are influenced by weather, in particular, rainfall. Due to the increased weather variability, peanut producers have turned to irrigation to stabilize peanut production. However, many traditional peanut production areas depend on natural rainfall and do not or cannot irrigate. When droughts occur, the incidence of aflatoxin in peanuts increase dramatically. Since peanuts are a major food ingredient, the presence of aflatoxin is detrimental from a food safety sense. When peanut production was controlled under the old peanut program, the food industry including shellers had to develop means to minimize the presence of aflatoxin in food products at a cost. With new program, the food industry along with shellers will be able to contract with growers that can ensure minimum levels, if any, aflatoxin. These growers will be producing peanuts with irrigation.

Figure 2 provides the major peanut producing states along with the coloring of the areas where peanut production currently occurs. Many of these areas may change with the implementation of the new peanut program. New Mexico and Virginia may be the two most vulnerable states. Under the old peanut program, New Mexico had a special feature in producing Valencia peanuts, which isolated and protected them even from competition from other areas in the U.S. Furthermore, New Mexico has a direct charge on water usage that its neighboring state Texas does not. Based on cost alone, one could see a shift from New Mexico to the Texas Panhandle area in the production of Valencia. Virginia also has some high cost of production in

its traditional peanut production area. This is due to intense pressure from peanut diseases like CBR and sclerotinia. Furthermore, some of the Virginia peanut area is having urban encroachment which escalates the land values. Thus, Virginia may potentially decrease its peanut production of Virginia type peanuts. North Carolina may increase its share of production using land that use to be used for tobacco production. Peanut production in Alabama may decrease since the majority of production is non-irrigated. Florida's production should increase if the market incentives are there, especially in the central area of Florida. Manufacturers like to have new crop peanuts earlier in the season, which Florida could provide. Peanut production may intensify in the northeast section and in the southwest section of the peanut belt in Georgia. Oklahoma will probably see a decline in production with the eastern part of the state shifting out of peanut production. Central Texas was shifting out of peanut production under the old program and the new program will speed the process up.

While there might be shifts in peanut production area, cropping patterns may also change due to the new farm bill. As was debated during the Farm Bill in regards to "rebalancing" the market loan rate of soybeans to corn, feed grains and wheat, the balance of the market loan rate for peanuts relative to other crops produced in the South must be considered. Table 4 provides the various cost of producing peanuts in the U.S. based on three different yields. Based on this USDA data, if the average yield is 3000 lbs per acre, the Virginia-North Carolina region is the only area that would have trouble covering their variable expenses at the marketing loan level of \$355 per ton. However, if the average yield is 4000 lbs per acre, all peanut producing areas would be able to at least cover the variable expenses. The last yield considered was the USDA average yield. Using this yield, the Texas-Oklahoma area and depending on the year, Georgia-

Figure 2. The Nine Major U.S. Peanut Producing States (shaded areas represent peanut growing areas within the states)

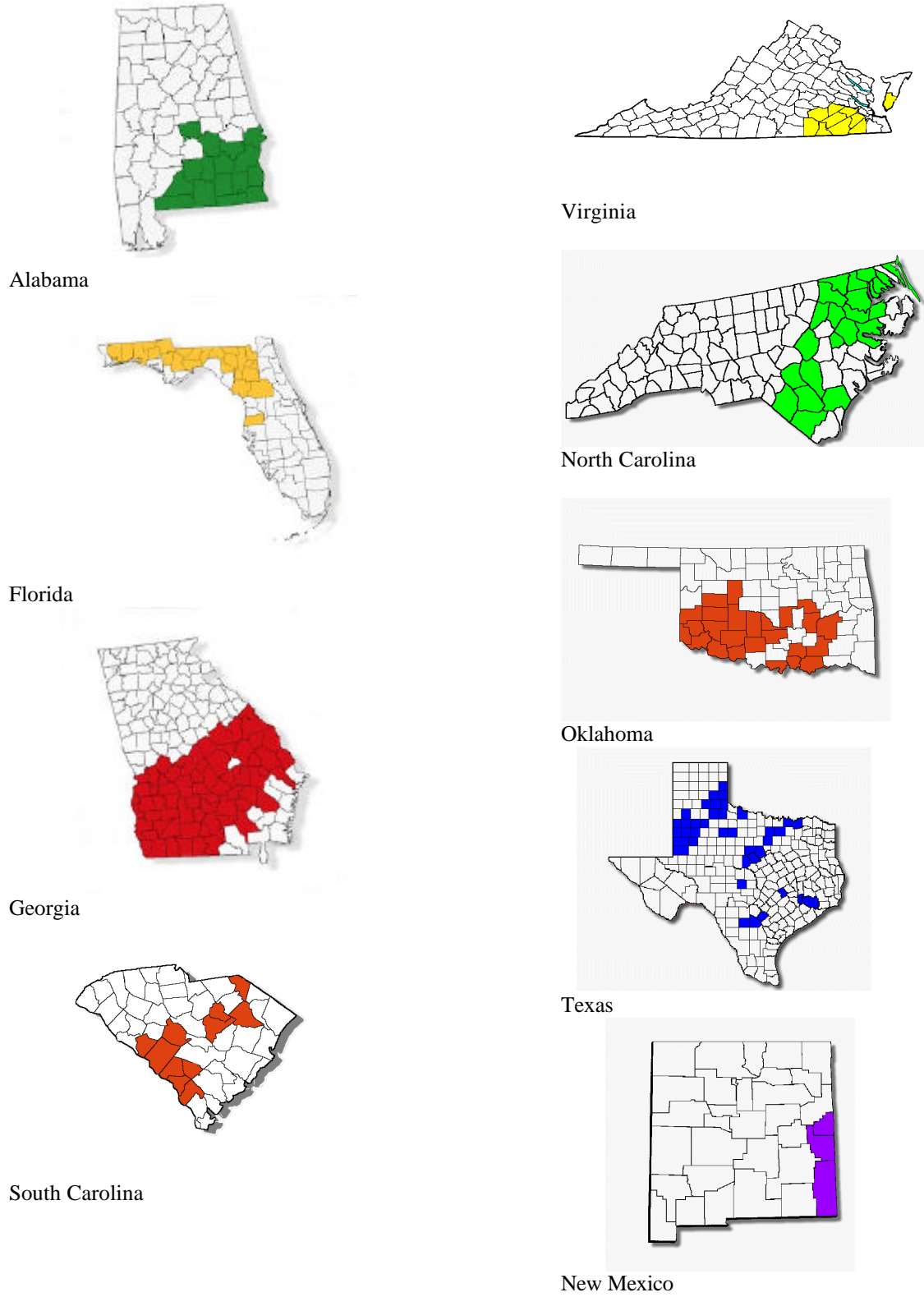


Table 4. USDA Peanut Cost of Production, by Regions, 1997-1998 (\$/ton)

Item	United States		Prairie Gateway		Southern	Seaboard		
	1997	1998	1997	1998	AL, GA 1997	AL, GA 1998	VA, NC 1997	VA, NC 1998
3000 lb per acre yield								
Total, operating costs per ton	230.13	219.12	160.69	138.21	250.45	247.34	285.37	283.49
Subtotal - variable cost per ton	301.76	285.87	235.55	200.33	316.72	311.73	371.20	368.60
Total costs listed less quota rent per ton	459.31	433.92	396.89	341.77	469.75	459.67	535.86	529.47
Total costs listed per ton	525.49	494.70	444.05	377.29	544.13	531.93	599.95	591.97
4000 lb per acre yield								
Total, operating costs per ton	172.60	164.34	120.52	103.66	187.84	185.51	214.03	212.62
Subtotal - variable cost per ton	226.32	214.40	176.67	150.25	237.54	233.80	278.40	276.45
Total costs listed less quota rent per ton	344.48	325.44	297.67	256.33	352.32	344.76	401.90	397.11
Total costs listed per ton	394.12	371.03	333.04	282.97	408.10	398.95	449.97	443.98
USDA Yields	2537.00	2574.00	1993.00	1635.00	2608.00	2818.00	3237.00	3582.00
Total, operating costs per ton	272.12	255.38	241.88	253.60	288.09	263.31	264.48	237.43
Subtotal - variable cost per ton	356.83	333.18	354.57	367.57	364.33	331.87	344.02	308.71
Total costs listed less quota rent per ton	543.13	505.73	597.42	627.11	540.36	489.36	496.63	443.45
Total costs listed per ton	621.40	576.57	668.41	692.28	625.92	566.29	556.03	495.79

Alabama could have trouble covering variable expenses. If a producer only looks at their cash flow, total peanut production should not decline. However, to maintain a long-term survival of the industry, variable and fixed costs must be covered. Thus, peanut producers will need to receive more than market loan price. Given these cost of production numbers and depending on how cotton costs are relative to market prices, one may see some acreage shifts between cotton and peanuts. Preliminary analysis indicates that in terms of cash flowing, peanuts may do better than cotton in many situations. However, the need to rotate peanuts in order to suppress disease and pest pressure will temper any major acreage shifts.

While production areas and cropping patterns may shift, the peanut infrastructure changes will probably be relatively more dramatic when compared to the current structure. For example, grading will change and the question of what the grading will be and who pays is of concern. Previously, the Peanut Administrative Committee had oversight of this function. Any changes in the grading system had to be approved by them. While manufacturers and shellers sought to make changes in the grading system to reflect newer technologies, producers resisted. Since this Committee was equally divided, changes seldom occurred. Given that the new peanut program eliminated the Peanut Administrative Committee and replaced it with the Peanut Standards Board that will only serve as an advisory board, major changes will occur in the grading system. The old system did not pass any market signals from the consumer down to the producer. The new system when developed should incorporate that function. Other issues of importance to peanut producers are handling fees, storage cost and transportation cost. Given that peanuts are a semi-perishable commodity, these issues are very important to them. A producer cannot easily store peanuts on the farm like he/she can with wheat.

The buying points role in assembling the peanuts between the producer and the sheller will change significantly. What their role in the marketing loan program is unknown. The average size of a buying point in the Southeast is less than 5,000 tons of peanuts. To be competitive in the new market, this average size will probably need to be three to four times larger at least. They will need to segregate the incoming peanuts according to quality and type. This will involve a change in how peanuts are handled and stored.

Will the farmer, buying point and sheller segment of the industry move towards a grain marketing system? This is one of the questions being asked in the industry. However, given the semi-perishability of peanuts, will this lead to vertical integration like poultry and pork? What is the potential of vertical integration either top down or bottom up? The change in the peanut program opens up many options for the peanut industry to transform itself. Time will tell which direction it will take.

CONCLUSIONS

While peanuts may be regarded as a minor crop on a national scale, peanuts are a key integral component of Southern agriculture and the Southern rural economy. Many of the peanut product manufacturing facilities and the entire peanut shelling facilities are located in the same local Southern communities where peanut production occurs. This provides jobs and additional economic activity to the Southern communities.

Given the importance of peanuts to the local Southern rural economy, the U.S. trade policy and domestic farm policy were on a collision course. This was clearly evident during the recent Farm Bill debate. One group wanted to basically ignore the implications of the U.S. trade policy while the other group wanted to create a new domestic farm policy within the structure of the U.S. trade policy.

The opportunities and challenges under the new peanut program were spelled out and discussed. Changes will occur for the U.S. peanut producers as well as for the local Southern rural economies. The challenge will be to take the change by the hand instead of having change take them by the throat (paraphrasing Winston Churchill's quote).

REFERENCES

Cotton, Thomas R. (Dell). *Can We Compete with Imports?* Peanut Grower Magazine, March 2001.

Fletcher, S.M. *Peanuts*. Colyer, et al (eds). Competition in Agriculture: The United States in the World Market. The Haworth Press, Inc. New York. 2000.

Revoredo, C.L. and S.M. Fletcher. "The Competitiveness of Argentine Peanuts and the U.S. Domestic Price under Different Domestic Policies." Working paper. National Center for Peanut Competitiveness, University of Georgia.