

## Commodity Spotlight



USDA photo: Ken Hammond

## Peanut Consumption Rebounding Amidst Market Uncertainties

**P**eanuts and peanut products (peanut butter, ball park nuts, peanut candies, and salted peanuts) are a familiar and longstanding staple in the American diet. Peanuts are also valued when crushed—as high-protein animal feed and as vegetable oil preferred for its long shelf life and cooking qualities. In the U.S., though, most peanuts are consumed directly (as peanuts or peanut products), so the edible non-oil food-use category of demand for peanuts is vital to income prospects for peanut farmers. This is especially the case since the U.S. peanut program provides a relatively high price support level for U.S. peanuts allowed to be marketed for domestic food use ("quota" peanuts). This quantity depends on anticipated demand for the following year, and is adjusted annually by USDA. All peanuts produced beyond this level ("additional") must be channeled into lower valued export or crush markets, and are only eligible for a much lower support rate.

Food use has rebounded from a decline during the early 1990s, and is forecast at record levels in 2001/02. Nevertheless, U.S. peanut farmers have faced new challenges since the mid-1990s, putting downward pressure on average farm prices and

bringing cash receipts in 1999 and 2000 to the lowest levels in almost two decades. These challenges include changes in domestic support policy under the 1996 Farm Act, increased access for peanut imports under trade agreements, and strong competition in export markets. The prospect of major changes to the peanut program under new farm bill proposals is also a source of uncertainty for peanut producers.

In the U.S., the dominant source of demand for peanuts—about 70 percent of total domestic consumption—is direct consumption (food use). Food use of peanuts is comprised of two main categories. *Shelled* peanuts include those used for peanut butter (about 45 percent of peanut food use), snack peanuts (23 percent), and peanut candy (21 percent). Roasted *in-shell* peanuts account for about 9 percent of U.S. peanut food use. The proportion of peanuts crushed for animal feed and vegetable oil is small, especially when compared with other oilseeds (e.g., soybeans). Lower quality peanuts ("pickouts") used for crushing make up only 18 percent of domestic consumption. Seed and residual uses account for the remaining 12 percent.

In 1989, domestic food use of peanuts peaked at 2.32 billion pounds (in-shell basis), or about 9.4 pounds per person. But, in the early and mid-1990s, prospects did not look good. A steady decline in demand reflected demographic trends (such as the smaller number of children among the baby-boomer generation), health and dietary concerns about fat content in peanuts, and competition from lower priced snack products.

From its peak in 1989, domestic food use declined 15 percent by 1995, to just over 2 billion pounds (in-shell basis). Press reports of severe allergic reactions to peanuts among a small number of consumers may also have reduced household and institutional (e.g., by airlines and schools) demand during this time.

U.S. peanut consumption has turned around since 1995 as food use rose almost without interruption to a projected record of 2.34 billion pounds in 2001/02. The cause of the revival is not entirely clear. Some observers have attributed it to reduced concern about fat in foods, a growing awareness of studies linking peanut consumption to improved health, the introduction of new products (e.g., flavored in-shell peanuts), and increased retail promotion by peanut product manufacturers and industry associations. Promotional efforts have highlighted the fact that peanuts, while relatively high in fat, are also a good source of protein, contain no cholesterol, and are low in saturated fats—the type most associated with coronary heart disease.

Despite higher peanut consumption, farm-level income from peanuts in 2000/01 was below \$1 billion for the second straight year—at \$896 million. Gross farm income from peanut production in 1991/92 (a record crop year) was nearly \$1.4 billion, and had not been below \$1 billion since 1983. Although producers enjoyed record yields in 2001/02—at over 3,000 pounds per acre—and the highest peanut production since 1994/95, low monthly average farm prices in the key first quarter of the current 2001/02 marketing year (August-July) portends only modest revenue gains for peanut farmers. Weak average prices reflect the large crop and mounting ending stocks, which are projected at a record high.

## Impact of Farm Policy & Trade Agreements

The general decline in income is rooted in domestic support program changes and trade policies enacted during the mid-1990s that lowered support to domestic peanut producers and opened the door to increased import competition for the domestic edible peanut market. The decline in revenues is also tied to fading demand for exports and crushed peanuts compared with levels of the early 1990s. In particular, the export market—an important outlet for U.S. additions—has become increasingly competitive with a surge in production and exports from the world's leading peanut producer, China. The crushed value of peanuts has also weakened in the face of depressed prices of competing substitutes, such as soybean meal and oil.

The 1996 Farm Act did not fundamentally alter the U.S. peanut program, but several modifications effectively lowered income potential from peanut production. Among the more significant were those affecting the quota support price and the quota itself—the amount producers can sell for domestic food use.

The quota support price was lowered from \$678 per short ton during 1995 to a fixed \$610 per short ton during the 1996-2002 crop years. The quota poundage is now set annually at the projected level of U.S. food and related use demand, and there is no longer a required minimum (as in previous legislation).

For the 1991-95 crops, USDA was required to set the quota amount at a minimum of 1.35 million short tons, regardless of anticipated domestic food demand. The quota for the 1998 through 2002 crop years has been set at 1.18 million short tons (not including a separate quota for seed peanuts). In addition to lowering the support price, the 1996 Farm Act eliminated an automatic escalator, which allowed the support price to increase annually by up to 5 percent, based on the previous year's production costs. These changes were intended to make the peanut program operate at no net cost to the government. If the quota amount and support price had been left unchanged at the higher levels, it is possible that demand by

## Congressional Proposals Would Transform Peanut Program

Current proposals for the next farm bill contain substantial changes to the peanut program. Passed in October 2001, the House Farm Security Act of 2001 (H.R. 2646) would eliminate the quota system. Peanuts would be treated similarly to "program" crops such as grains and cotton—with a system of direct support payments contingent on historical acreage, but not current production, and with marketing loan provisions. Farmers would no longer have to own or rent quota to produce for domestic food use. The proposal also includes a buyout for quota holders. Although it is uncertain what form the final farm bill will take, similar reforms of the peanut program are incorporated in the Senate version of the farm bill (S.1731), which was passed on February 13, 2002.

The proposals contain four main provisions. The fixed decoupled payment and countercyclical payments would be options only for those with a history of peanut production during 1998-2001:

- **Marketing assistance loan.** As with other crops eligible for marketing loans and loan deficiency payments, peanut producers, with or without a history of peanut production, would be eligible for a marketing assistance loan. The House proposed a loan rate of up to \$350 per short ton; the Senate proposed up to \$400. Producers could pledge their stored peanuts as collateral for up to 9 months and then repay the loan at a rate that is the lesser of: 1) the loan rate plus interest, or 2) a USDA-determined repayment rate designed to minimize loan forfeiture, government-owned stocks, and storage costs, as well as to allow free and competitive marketing of U.S. peanuts in domestic and international markets.
- **"Fixed, decoupled" payment.** Similar to the production flexibility contract payments made available to grain and cotton producers in the 1996 Farm Act, peanut producers would receive \$36 per ton of eligible production during the base (1998-2001) period. Eligible production would equal the product of: base-period yields (with provisions for unusual crop losses) and 85 percent of base-period acres planted to peanuts. These payments are considered fixed and decoupled because they are made regardless of current prices or so long as the area remains in an approved agricultural use.
- **"Countercyclical" payment.** Producers with base acreage would receive financial assistance when market prices are below an established target price of \$480 per ton. The payment would be based on the difference between the target price and the higher of: 1) the 12-month national average market price for peanuts plus the \$36-per-ton fixed decoupled payment, or 2) the marketing assistance loan rate plus the \$36-per-ton fixed decoupled payment. Payments would be made on 85 percent of base (1998-2001) peanut production so long as the area remains in an approved agricultural use.
- **Quota buyout (compensation for loss of quota asset value).** Quota owners would receive compensation for lost asset value of their quota. 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.

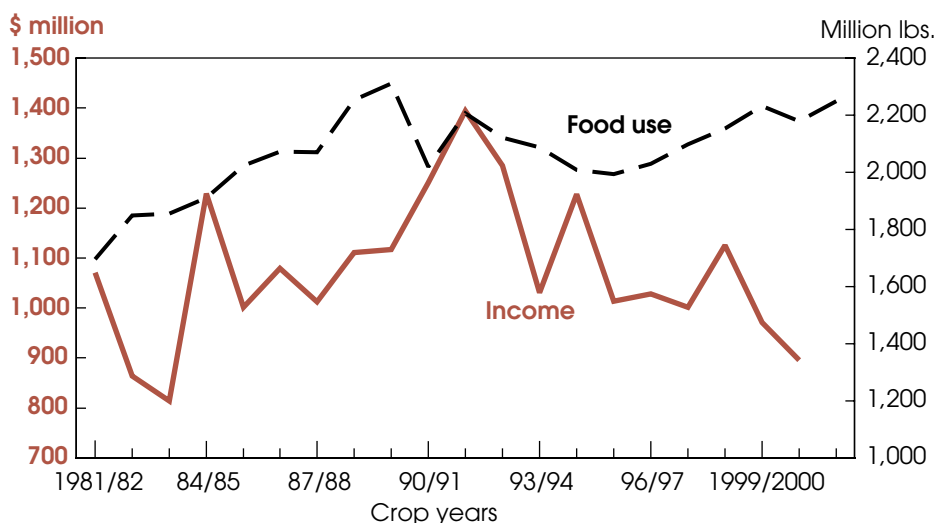
peanut processors and shellers would not have been sufficient to clear the market. In that case, the unsold quota peanuts would be defaulted to USDA for disposal in the lower priced crush market. Peanut quota holders are responsible for reimbursing these losses to USDA.

In addition to pressures stemming from changes to the domestic support program,

trade agreements began to expose U.S. producers to increased import competition in the mid-1990s. With only 5 percent of global peanut production exported, peanuts are far less widely traded than many other commodities, but for the U.S. peanut market, trade is an important component of both supply and demand. The U.S. is both a leading exporter (ranking second behind China) and a leading importer (ranking

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### Peanut Farm Income Down Sharply from Mid-1990s, Despite Higher Trending Food Use



2001/02 food use forecast.  
Economic Research Service, USDA

peanut imports from undermining the U.S. domestic support price program.

Without limitations on imports, the price support program for edible peanuts would not be sustainable at current quota loan rates and world peanut prices. Peanut processors and shellers would seek to avoid the high prices for domestic peanuts (usually at or above the \$610 per short ton quota rate) caused by production limitations, and instead import peanuts at a price (assuming equal quality) below that charged for domestic peanuts. If unrestricted imports were allowed, domestic quota peanuts could go unsold and either the quota would have to be drastically reduced or the quota support price brought closer to world prices.

However, under the URAA and NAFTA, the U.S. has opened its market to limited, but gradually increasing, quantities of peanut (and peanut butter) imports through a tariff-rate quota (TRQ) system. Under the URAA, the U.S. replaced the import quota with a TRQ, permitting a set amount of peanuts into the U.S. at a low in-quota tariff rate, but subjecting imports above that level to a much higher over-quota tariff rate. Most of the quota (78 percent) was reserved for imports from Argentina. The TRQ has specific tariffs for in-quota imports and *ad valorem* tariffs for over-quota imports. The in-quota tariff rate ranges from 6.6-9.35 cents per kilogram; the over-quota tariff rate currently ranges from 131.8 to 163.8 percent.

The quota amount in 2000 was set at 56,821 metric tons (shelled basis), representing about 7.5 percent of total U.S. peanut food use that year. The quota for all countries except Mexico is scheduled to remain fixed after 2000, but Mexico's quota is scheduled to continue increasing through 2007, to 4,815 metric tons as part of the NAFTA agreement. This represents a relatively small share of U.S. consumption. After 2007, imports from Mexico will be completely unrestricted, with no quota or tariff.

In the URAA, the U.S. also established a TRQ for peanut butter, with a duty-free quota level of 20,000 metric tons by 2000, and an over-quota tariff rate of 131.8 percent. The peanut butter TRQ is allocated mainly to Canada (14,500 metric tons) and

### Peanut Production, Domestic Food Use, and Exports To Rise in 2001/02

Year beginning August 1	Production	Domestic food use	Exports	Imports
<i>Million lbs.</i>				
1980/81	2,303	1,465	503	401
1981/82	3,982	1,696	576	1
1982/83	3,440	1,849	681	2
1983/84	3,296	1,856	744	2
1984/85	4,406	1,911	860	2
1985/86	4,123	2,023	1,043	2
1986/87	3,697	2,073	663	2
1987/88	3,616	2,071	618	2
1988/89	3,981	2,254	688	3
1989/90	3,990	2,312	989	4
1990/91	3,604	2,020	652	27
1991/92	4,927	2,207	1,002	5
1992/93	4,284	2,122	951	2
1993/94	3,392	2,088	533	2
1994/95	4,247	2,009	878	74
1995/96	3,461	1,993	826	153
1996/97	3,661	2,029	668	127
1997/98	3,539	2,099	682	141
1998/99	3,963	2,153	562	155
1999/00	3,829	2,233	743	180
2000/01	3,266	2,179	527	214
2001/02	4,239	2,240	725	178

2001/02 forecast.  
Sources: National Agricultural Statistics Service, USDA; U.S. Department of Commerce.  
Economic Research Service, USDA

fifth behind the European Union, Indonesia, Canada, and Japan).

Prior to the 1994 Uruguay Round Agreement on Agriculture (URAA) and the North American Free Trade Agreement (NAFTA), which became effective the

same year, U.S. peanut imports were limited to a specific and very low absolute level by Section 22 of the Agricultural Adjustment Act of 1933. The permitted quantity of 1.7 million pounds (shelled basis) represented barely one-tenth of 1 percent of domestic food consumption in 1993. This limit was designed to prevent lower priced



Argentina (3,650 metric tons). Under NAFTA rules of origin, Canadian exports of peanut butter and paste made with peanuts from another country are not considered of Canadian origin (and are subject to the TRQ) since Canada grows no peanuts. However, imports of Mexican peanut butter and paste face no restrictions so long as they are made with peanuts of Mexican origin. Mexican-produced peanut butter/paste enjoys a cost advantage over domestic production made with peanuts purchased at the high support price.

From virtually no exports to the U.S. prior to 1998, peanut butter and paste exports from Mexico were closing in on 5,000 metric tons during calendar year 2001. Mexico is a small but growing peanut producer, with annual production of 130,000-160,000 tons, and appears to have ample production to fuel continued growth of both peanut and peanut butter/paste exports to the U.S. But it is also likely that, in the near term, these exports will continue to represent only a small fraction of total U.S. peanut consumption and that Mexico will remain an important destination for U.S. peanut exports (averaging 25,000-40,000 metric tons annually).

In the wake of trade agreements, the quantity of peanut and peanut butter/paste allowed into the U.S. at the lower in-quota tariff rates currently represents approximately 10 percent of the U.S. domestic peanut market in 2000/01, up from 0.1 percent prior to 1995. Some observers have also pointed out that a number of products containing peanuts, including some peanut candies, cookies, and confectionery items, are not subject to TRQs and face lower tariffs than the over-quota rates charged on peanuts and peanut butter/paste.

### ***U.S. Exports Trend Down As Chinese Exports Surge***

Exports have been a key source of demand for U.S. peanut producers for decades. Since 1980, the percentage of U.S. production exported has ranged from 14-25 percent. Nearly all U.S. peanut exports are for direct human consumption. High-quality product and a reputation as reliable suppliers have enabled U.S. sellers to command a price premium in international markets.

## **Peanut Profile in a Nutshell**

Peanuts are believed to have originated in South America, probably in Brazil or Peru. Peanuts were introduced to Asia and Africa by Spanish explorers and to North America in the 1700s. Four main varieties of peanuts are produced in the U.S.: Runners, Virginia, Spanish, and Valencia.

The most common variety, Runners, accounts for about three-quarters of U.S. peanut production and is used mainly to make peanut butter (52 percent of Runners in 2000/01) but also in peanut candy (26 percent) and as snack peanuts (20 percent). The large, high-quality Virginia peanuts account for about 15 percent of domestic production and are more favored as snack peanuts (e.g., roasted in-shell peanuts and salted or honey-roasted peanuts). Spanish peanuts, with smaller kernels and higher oil content, are used mainly in peanut candies. The least common, Valencias, also have small kernels and are known for their sweetness. They are produced almost exclusively in New Mexico, and are usually roasted and sold in the shell.

At the national level, peanuts are a relatively minor crop, with farm-level value of production less than 5 percent of the value of corn production in 2000/01. But peanut production is concentrated in a small number of states and is a key contributor to local economies. Virtually all peanut production takes place in just nine states in three regions: the Southeast (Georgia, Alabama, Florida, and South Carolina), with 55 percent of national production; the Southwest (Texas, Oklahoma, and New Mexico), with 30 percent; and the Virginia-North Carolina region, with 15 percent.

Although global peanut trade increased slightly (4 percent) between 1990-95 and 1996-2000, U.S. exports during the same time period declined. U.S. peanut exports averaged 807 million pounds during 1990-95, but dropped by nearly 22 percent to 632 million pounds during 1996-2000. U.S. peanut exports in 2000, at 520 million pounds (valued at about \$135 million), were the lowest since 1980, but shipments are projected to rebound to 725 million pounds in 2001/02.

China emerged as the major competitor to the U.S. in 1980, with sales to Japan and other Asian countries, and small shipments to Western Europe. High peanut prices brought on by the 1980 U.S. drought, China's policy incentives for expanding oilseed production, and the opportunity to increase foreign exchange earnings were among the catalysts for increased exports by China.

From 1980 to 1996, the U.S. and China regularly exchanged position as the world's leading peanut exporter. In 1997 Argentina led in global exports, but since then China has led the world by a large margin and appears poised to remain the leading exporter for the foreseeable future due in part to its low production costs and the proximity of main production regions to ports.

In the past 5 years, peanut production in China—concentrated mainly in the eastern coastal province of Shandong—has soared, rising from an average of 7.8 million metric tons during 1990-95 to a projected 14.5 million metric tons in 2001 (more than 7 times U.S. production). While China's domestic consumption is rising nearly as much, the surplus has allowed exports to expand. However, the potential for increased exports from China may be restrained both by limits on area suitable for peanut planting, and by reports of problems with aflatoxin (a disease that makes the nuts inedible) in peanut exports from Shandong.

Like producers of other agricultural commodities in the past several years, U.S. peanut growers have confronted pressures from market forces and the impacts of policy developments. While demand prospects are brighter than in the mid-1990s, the outlook for peanut farmer incomes is clouded by the potential for higher imports, and increased competition in export markets. The prospect of further legislative changes to the peanut program is also a source of uncertainty for peanut producers. **AO**

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