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Comparing Quota Buyout Payments for Peanuts and Tobacco

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Summary

Legislation is pending in the 108th Congress (S. 1490, H.R. 3160) to eliminate tobacco quotas and compensate quota owners (whether they are absentee owners or active producers) at the rate of $8 per quota pound. Active producers would lose price support, but would receive a lump sum transition payment of $4 per pound on their production history, including the quota they own as well as any quota they rent. A precedent for quota buyouts was established in the 2002 farm bill, which terminated peanut quotas and compensated the owners with a $0.55 per pound payment. Active peanut producers continue to receive price support. A comparison of peanut and tobacco quota buyout rates shows that the two are substantially comparable (relative to past quota rental rates). However, current USDA budget projections indicate that continuing operation of the peanut subsidy program likely provides significantly higher benefits than the proposed tobacco transition payment (relative to the costs of production of each commodity).

Both peanuts and tobacco have had a long history (dating back to the 1930s) of federal price support achieved through a combination of marketing quotas and nonrecourse loans. The 2002 farm bill (P.L. 107-171, Sec. 1301-1310) ended peanut quotas with a buyout payment to peanut quota owners, but continued a support program for producers. Legislation is pending in the 108th Congress (S. 1490, McConnell; H.R. 3160, Fletcher) that likewise would provide tobacco quota owners with a buyout payment. However, unlike peanuts, active tobacco producers would be given a lump sum transition payment but no future support. Another important distinction is that tobacco payments would be funded from assessments on tobacco product manufacturers and importers. In contrast, peanut buyout payments and continuing support program operations are funded by the federal government.

The purpose of this analysis is to provide a generally consistent comparison of the benefits provided to peanut quota holders and producers and proposed benefits concerning tobacco. It is not the intention of this analysis to attempt to determine the appropriate size of these buyout payments.

Peanuts

There were about 12,000 farms that harvested an average of 111 acres of peanuts in the United States in 1997, according to the Census of Agriculture. In 2002, total peanut production was 3.32 billion pounds harvested from 1.30 million acres. The leading production states were Georgia (40%) and Texas (26%), with the remaining 34% of output coming from Alabama, North Carolina, Florida, Oklahoma, Virginia, New Mexico, and South Carolina. With a season average price of $0.179 per pound, the value of the 2002 crop was $594 million.[1]

Prior to 2002, federal support prices for peanuts were guaranteed through a two-tiered nonrecourse loan program that differentiated between peanuts marketed for domestic edible consumption ($0.305 per pound loan rate in 2001) and peanuts crushed for oil and meal or exported ($0.066 per pound loan rate in 2001). In order to minimize the cost of the nonrecourse loan program, marketing quotas were allocated among producers to limit the quantity of peanuts eligible for the higher support given on domestic edible production. In addition, import quotas allowed only a small, but gradually increasing, quantity to enter the U.S. market from overseas. In 2001, imports amounted to about 6% of domestic use, according to the U.S. Department of Agriculture (USDA).

The 2002 farm bill, which applies to the six crop years 2002 through 2007, replaced the old framework of peanut support with a new framework identical to that adopted for soybeans, wheat, corn, cotton, and rice. Now, producers with a past peanut production history are eligible for annual fixed direct payments of $0.018 per pound on 85% of their base production. USDA's average budgeted cost for these direct payments to peanut producers is $65 million per year.

The same producers are eligible for counter-cyclical payments when the marketing year average farm price falls below a target price of $0.2475 per pound. USDA's payment rate on 85% of base production was $0.086 per pound in 2002 and was estimated to average $0.092 per pound in future years (for an average annual total of $175 million per year). All farmers eligible to receive direct and counter-cyclical payments have planting flexibility privileges, and so may produce peanuts or other eligible crops. [2]

Farms that actually produce peanuts, and there is no restriction to limit entry, are eligible for marketing assistance loans or loan deficiency payments on their total production. The loan rate for all peanuts is $0.1775 per pound. The value to producers of marketing loan gains and loan deficiency payments depends on how low market prices drop below the loan rate each year. USDA's budget estimate anticipates an average annual payment of about $0.033 per pound of peanut production, for an average annual total cost of almost $136 million.

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[1] Unless otherwise documented, the data characterizing peanut and tobacco farms, production, and prices are from the USDA, National Agricultural Statistics Service.

[2] Here, and throughout this analysis, budget data are from the USDA, Commodity Credit Corporation, Commodity Estimates Book, FY 2004 President's Budget, February 3. 2003.

The combined average estimated budgeted cost of direct payments, counter-cyclical payments, and marketing loan benefits is about $0.091 per pound of actual projected peanut production, or $376 million per year.

Peanut quota owners were given direct payments to compensate for lost quota values. This quota buyout payment was equal to $0.55 per pound on 2001 quota levels. Quota owners had the option of a lump sum payment or five equal annual installments of $0.11 per pound. Nationally, quota buyout payments were estimated by USDA to cost a total of $1.475 billion.

Tobacco

There were 90,000 farms that harvested an average of 9.3 acres of tobacco in the United States in 1997, according to the Census of Agriculture.[3] In 2002, total tobacco production was 881 million pounds harvested from 429,000 acres. The leading states were North Carolina (40%) and Kentucky (25%), with an additional 30% of production coming from Tennessee, Virginia, South Carolina, and Georgia (the remaining 5% came from 10 other states). With a season average price of $1.907 per pound, the value of the 2002 crop was $1.726 billion.

The price of each kind of federally supported tobacco is now guaranteed through nonrecourse loans. The two major kinds of tobacco, which both receive price support and together constitute nearly 95% of U.S. tobacco production, are flue-cured and burley. The 2003 loan rate for flue-cured is $1.663 per pound, and for burley is $1.849 per pound. The loan rates are set each year by USDA using a formula mandated by law.

The loan program, under a legal mandate enacted in 1982, is supposed to operate at no net cost to taxpayers. If tobacco is put under loan by producers and later is sold for less than the loan principal plus interest, losses are supposed to be covered from assessments on growers and buyers of tobacco. From FY1983 through FY2002, tobacco operations have resulted in a cumulative net federal expenditure of nearly $1.4 billion (an annual average of $69 million). The reason for the net expenditure largely is due to the congressionally mandated assumption of losses on large loan inventories that developed in 1983 and 1999, as well as direct payments in FY2000 and FY2001 to offset recent reductions in quota. (See CRS Report RS20802, *Tobacco Farmer Assistance*.)

Similar bills in the Senate (S. 1490) and House (H.R. 3160) would make buyout payments to quota owners and transition assistance payments to active producers. Tobacco quota owners (including an estimated 335,000 that are not actively producing the crop and 81,000 that are active producers) would be paid $8 per pound of basic quota that they were assigned in past years. The 81,000 active producers would receive a separate payment of $4 per pound on their effective quota in past years as transition assistance to a market environment absent federal support.

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[3] Since 1997, the number of farms producing tobacco has declined as production has been consolidated, and the acreage harvested has declined due to the drop in national quotas under the price support program. An updated count of farms will be forthcoming when the 2002 Census of Agriculture is published.

The total expected cost of each bill is about $15 billion, which would be collected from tobacco product manufacturers and importers (about 98% from cigarette manufacturers). On a per pack basis, using the 2002 U.S. consumption rate of 21 billion packs, $15 billion is equal to $0.714 per pack. Spread over the life of the buyout payments, the average annual cost to manufacturers and importers would be $0.10 to $0.12 per pack per year (if consumption remains constant). How much of this cost would be passed on to consumers and how much would be absorbed by manufacturers is uncertain.

Comparing Peanut and Tobacco Buyout Payment Rates

While the peanut quota buyout and farm support provisions of the 2002 farm bill are not identical to the proposed buyout program for tobacco, comparisons are possible. The following analysis is based on revenue and cost of production data for 2001, published by USDA's Economic Research Service. The analysis is divided into two parts.

First, a comparison is made of quota buyout payment for peanuts and tobacco. Owners of quota may be non-producing or absentee owners earning rent by leasing the quota to active producers (farm operators). Absentee quota owners give up all future rental income when they accept a quota buyout. Quota owners who are active producers realize a drop in the value of their land when quotas are eliminated.

Second, a separate comparison is made of payments to active producers. After the quota buyout, peanut producers became eligible for continuing annual subsidy program payments. In the pending tobacco legislation, active producers would receive a lump sum payment and there would be no future ongoing subsidy program.

Quota Buyout Payments. The proposed quota buyout payment of $8 per pound for tobacco, and the actual quota buyout payment of $0.55 per pound for peanuts, is compensation for forgone future rental or asset values. Using a discount rate of 5%, a lump sum payment of $0.55 is the equivalent of annual income of $0.028 each year in perpetuity; a lump sum payment today of $8 is the equivalent of rental income of $0.40 each year in perpetuity. Using these calculations as a standard for comparison (see **Table 1**), the buyout payment to peanut quota owners (amounting to 74% of average annual rent) appears to be somewhat less favorable than the proposed payment for tobacco quota owners (85% of average annual rent for flue-cured and 97% for burley).

Table 1. Quota Rental Rates for Peanuts and Tobacco

	Peanuts	Flue-cured	Burley
1995	$0.042	$0.41	$0.59
1996	$0.036	$0.40	$0.38
1997	$0.039	$0.37	$0.26
1998	$0.035	$0.44	$0.28
1999	$0.037	$0.52	$0.35
2000	$0.040	$0.57	$0.50
2001	$0.032	$0.59	$0.52
7-Year Simple Average Rent	$0.037	$0.47	$0.41
Quota Buyout Annual Rent Equivalent	$0.028	$0.40	$0.40
Buyout as Share of Average Rent	**74%**	**85%**	**97%**

Source: Primary data are from USDA, Economic Research Service, periodic cost of production reports. The rental rates for flue-cured and burley tobacco include a small land fee while for peanuts the rental rate is for quota only. Another data series developed by Dr. Will Snell, University of Kentucky, estimates the 7-year average burley quota rent at $0.44 per pound, which would put the buyout at 92% of the average burley rent.

Producer Assistance Payments. The quota buyout proposal for tobacco includes a $4 per pound payment for active producers to serve as transition assistance to a new economic environment without federal price support. In contrast, peanut producers have continuing federal support in the form of annual fixed direct payments, counter-cyclical payments, and marketing loan benefits.

The $4 per pound payment for active tobacco producers is equivalent to an annual subsidy of $0.20 per pound in perpetuity on base production (using a discount rate of 5%). Peanut producers are expected to receive an average of $0.091 per pound on estimated actual production (USDA budget estimate). As displayed in **Table 2**, the $0.091 yearly peanut payment is 57% of 2001 cash expenses, while a $0.20 per pound yearly tobacco payment is 19% of 2001 flue-cured cash expenses and 25% of burley cash expenses.

The USDA estimate of $0.091 per pound as the average annual future cost of the peanut support provisions can be converted to a lump sum present value of $1.82 per pound (using a present value formula with a discount rate of 5%). For purposes of comparison with the tobacco payment, a $1.82 per pound lump sum payment to peanut producers would be 11.4 times greater than cash expenses, while $4 per pound for tobacco is 3.9 times greater than flue-cured cash expenses and 4.9 times greater than burley cash expenses in 2001.

Table 2. Comparison of Peanut and Tobacco Producer Payments
(2001 Crop Year Data)

	Peanuts	Flue-Cured	Burley
	Dollars Per Pound		
1 — Market Revenue (Season Average Price)	$0.23	$1.86	$1.97
2 — Less: Cash Expenses	$0.16	$1.03	$0.81
3 — Equals: Net Cash Revenue	$0.08	$0.82	$1.16
4 — Producer Lump Sum Payment [a]	$1.82	$4.00	$4.00
5 — Annual Support Payment [a]	$0.091	$0.20	$0.20
6 — Lump Sum Producer Payment as Multiple of 2001 Cash Expenses (line 4 ÷ line 2)	**11.4**	**3.9**	**4.9**
7 — Annual Producer Payment as Share of 2002 Cash Expenses (line 5 ÷ line 2)	**57%**	**19%**	**25%**

Source: Data on 2001 market revenue and cash expenses are from USDA, Economic Research Service. Data on expected peanut support payments are from USDA, Farm Service Agency. Calculations are by the author.

[a] Peanut producers are eligible each year for marketing loan benefits, direct fixed payments, and counter-cyclical payments for the 6-year life of the 2002 farm bill. USDA's budget projects an average annual cost of $0.091 per pound for payments (from 2002 through 2008). If producers were to receive this benefit indefinitely into the future, the discounted present value would be equal to $1.82 (using a discount rate of 5%). The proposed $4 per pound lump sum tobacco producer payment is equivalent to an annual payment of $0.20 per pound in perpetuity (using a discount rate of 5%).

The most obvious difference between tobacco and peanuts in the above calculations (in **Table 2**) is the comparatively high benefit to peanut producers from the continuing support program compared to the proposed lump sum payment to tobacco producers. Whether comparing annual payments to cash expenses, or comparing lump sum payments to cash expenses, flue-cured producer payments are 34% and burley producer payments are 43% of peanut producer payments. The quota buyout payments for peanuts and tobacco (in **Table 1**) appear to be reasonably comparable, though this is a matter of interpretation.

The data in the tables are presented for the purposes of making generally consistent comparisons across totally different commodities with dramatically different unit prices and costs of production, and thus are potentially subject to misinterpretation. Despite this admittedly inexact comparison, the data do appear to indicate that the continuing support program provided to peanut producers likely will generate substantially more benefit than the proposed $4 per pound lump sum transition payment for tobacco producers. The financial adequacy to farmers of either the peanut program or the proposed tobacco program is not the subject of this analysis and it should not be used for such purposes.