September 26, 1995

REFORM THE SUGAR, PEANUT, AND DAIRY PROGRAMS

INTRODUCTION

As part of congressional budget reconciliation, the House Agriculture Committee considered the Freedom to Farm Act (H.R. 2195) on September 20. This legislation, sponsored by Committee Chairman Pat Roberts (R-KS), would significantly change the wheat, feed grains, cotton, and rice programs. Before the legislation was considered in committee, Roberts also incorporated serious reform of the dairy program into the Act. With certain modifications, the proposal represents serious reform of America's obsolete farm programs.[1]

Unfortunately, Chairman Roberts' attempt to provide a beginning for real reform suffered a setback when entrenched special interests, led by the National Cotton Council, succeeded in lining up a majority of the committee to vote against his bill. Nevertheless, the possibility for real reform is not yet dead, because the proposal may be considered again later this week, either by a reconvened House Agriculture Committee or by the House Budget Committee. Because a majority of the members of the House Agriculture Committee already have demonstrated their hostility to reform, the prospects for success appear better in the House Budget Committee.

Later this week, the Senate Agriculture Committee also will address budget reconciliation, and Chairman Richard Lugar (R-IN), who has been an advocate of fundamental reform, may propose incorporation of a number of provisions drawn from the Freedom to Farm Act. Unlike the House, the Senate Agriculture Committee must resist the pressure of entrenched special interests and support the end of farm welfare.

While the Freedom to Farm Act proposes reform for some programs, other important programs are overlooked. The Act does not include reform of either the sugar or peanut programs, even though these programs also face reauthorization this year and

1 For a complete discussion of changes needed to improve the Freedom to Farm Act, see John E. Frydenlund, "The Freedom to Farm Act (H.R. 2195): Key Changes Will Improve Potential for Serious Agriculture Reform," Heritage Foundation *Issue Bulletin* No. 211, September 5, 1995.

must be addressed, either in budget reconciliation or in the 1995 farm bill. Their anti-competitive and tightly controlled production systems limit the supply of these commodities while insulating these industries from the demands of the market. Removing supply restrictions will allow these industries to respond more effectively to new market opportunities and contribute to the nation's economic growth.[2]

In July, during consideration of the House agriculture appropriations bill, Chairman Roberts promised reform-minded Members that they would have an opportunity to offer amendments to reform the sugar and peanut programs during floor consideration of the farm bill. These promises, and the argument that Members should wait for the farm bill to offer amendments that change agricultural policy, succeeded temporarily in slowing the drive for reform. But whether these programs are dealt with in the farm bill or in reconciliation, any proposals considered must represent real reform.

The Agriculture Committees must not take the politically convenient course and adopt policies that preserve the anti-competitive aspects of the sugar and peanut programs. While the budget reconciliation instructions might provide the impetus for them to accept some sort of phase-down or phase-out of the more expensive commodity programs for wheat, feed grains, cotton, and rice, there is no similar pressure to reform the sugar, peanut, and dairy programs. These programs are different because wheat, feed grains, cotton, and rice are supported through subsidies based on what is produced. This amounts to a direct transfer of funds from taxpayers to producers. In no-net-cost programs, however, the commodity is supported through tightly limited production. This amounts to a transfer of funds from consumers to producers at little or no cost to the Treasury. Nevertheless, no-net-cost programs still impose significant economic costs on the nation.

REFORMING THE SUGAR PROGRAM

The current sugar program operates as a cartel in which a handful of wealthy processors determine who has the right to produce sugar in this country. Production is supported by loans of 18 cents per pound for raw cane and refined beet sugar, an amount determined by a formula that supposedly reflects the relative difference in producer returns for sugar beets and sugarcane. The result is a U.S. price nearly twice as high as the world price. The law requires that this program be operated at "no-net-cost" to the government, which means prices must be maintained at levels high enough to avoid forfeiture to the government. To assure this, the government imposes import quotas and a system of domestic marketing allotments to limit the amount of sugar processed for domestic use. While the amount of sugar refined may exceed the marketing allotment, it may not be sold in the United States. This further stifles domestic production.

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2 For a complete discussion of the economic impacts of ending supply controls for wheat, feed grains, cotton, and rice, see John E. Frydenlund, "How Freeing America's Farmers Would Mean a $135 Billion Boost," Heritage Foundation *Issue Bulletin* No. 214, September 19, 1995.

Because there is no cost to the taxpayers,[3] defenders of the sugar program argue that it should be preserved. However, this program—which controls sugar prices, limits imports to keep the prices high, and then dictates how much domestically produced sugar can be sold—does impose a cost of $1.4 billion annually on U.S. consumers,[4] who are forced to pay it through higher prices for products containing sugar. Moreover, consumers are not the only ones hurt. Because of its excessive subsidies, the program has forced a number of refineries that process raw sugar to close, eliminating domestic jobs and displacing workers.

There have been discussions within certain segments of the sugar refining industry and among Agriculture Committee members about offering an alternative to the current sugar program that would reduce the support price from 18 cents per pound to 14 cents in the 1996 crop year, 13 cents in the 1997 crop year, and 12 cents in the 1998 crop year. Thus, the support price would have a floor of 12 cents per pound even though the world price is now at about 11 cents per pound and frequently has been much lower. This proposal also would terminate the sugar marketing quota and allotment program, but without making the sugar industry responsive to the world market price. It therefore fails to correct the problems of the current system.

The sugar program is big government and corporate welfare at their worst. Almost half of its $1.4 billion in benefits goes to one percent of sugar growers. In fact, 33 growers and corporations each receive more than $1 million per year, and one Florida family received more than $65 million in one year alone.[5]

The Sugar Reform Act of 1995 (H.R. 1687), introduced by Representatives Dan Miller (R-FL) and Charles Schumer (D-NY), and a Senate companion bill (S. 847) introduced by Senators Judd Gregg (R-NH), Harry Reid (D-NV), and Bill Bradley (D-NJ) represent real reform that would benefit both farmers and consumers. Both the support price and the domestic marketing allotments would be eliminated immediately, allowing farmers to produce sugar to meet the demands of a free market. Unfortunately, all proposals introduced so far maintain existing import restrictions which artificially raise domestic prices for consumers. If the sugar program was eliminated, a market-oriented and internationally competitive policy would provide both reasonable sweetener prices and adequate supplies.

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3 Although GAO estimates that the sugar program generates about $30 million in revenues through marketing assessments on sugar, in a letter dated July 18, 1995, it also estimated that, as a result of the sugar program, it cost the government an additional $90 million just to purchase food and provide the level of food assistance it delivered in 1994.

4 See U.S. General Accounting Office, *Sugar Program: Changing Domestic and International Conditions Require Program Changes*, GAO/RCED-93-84, April 1993.

5 *Ibid.*

REFORMING THE PEANUT PROGRAM

Incredibly, the peanut program actually restricts the right of Americans to produce peanuts. By establishing a quota system, it gives a limited few the exclusive right, based on inheritance or purchase, to produce peanuts in the United States for the U.S. market at a guaranteed high level of price support. These "quota" peanuts are supported at a much higher price ($678 per ton) than non-quota or "additional" peanuts, which are supported at $132 per ton. Only quota peanuts can be marketed in the U.S., while non-quota peanuts must be exported, sold to a processor responsible for exporting them, or sold to the government. To protect holders of peanut quotas even more from the effects of competition, peanut imports also are severely restricted.

The peanut program is unfair not only to any farmer that would like to grow peanuts but cannot obtain a license, but also to those who succeed in buying or renting the right to produce peanuts. Two-thirds of those who own peanut growing licenses are not farmers, so farmers often must rent licenses from others. In fact, this usually is the most significant cost of producing peanuts. Although the cost of this program to taxpayers has been growing in recent years, the greatest cost falls on consumers who—again—are forced to pay higher prices.

Proponents of maintaining the status quo are not concerned with the cost to consumers. They want to make the peanut program into another "no-net cost" program in the hope of preventing radical change. One way to do this is by merely reducing the support for quota peanuts from $678 a ton to $600 or $550 a ton. But while this approach might reduce the cost to taxpayers temporarily, based on current market prices, there is no assurance that costs would remain limited in the longer term. Nor would there be any expected reduction in the $300 million the program annually costs consumers; if world prices drop, the cost of the domestic program will increase.

The only way to be sure that there is no cost while retaining the present structure is to restrict production further by reducing the amount of quota peanuts that can be produced. But, such a regressive action would penalize domestic consumers even more while reinforcing the barriers to entry in growing peanuts. Defenders of the status quo also have suggested that reducing the amount of quota peanuts—in other words, reduce the supply to inflate the price—could reduce the cost of the program.

Such "reform" proposals are nothing but a hoax. The peanut program, like the sugar program, is beyond repair and no amount of tinkering can improve it. The only genuine reform of the peanut program is contained in the Peanut Reform Act of 1995 (H.R. 2008), introduced by Representatives Christopher Shays (R-CT) and Andrew Jacobs (D-IN), and the companion Senate bill (S. 1027) introduced by Senators Hank Brown (R-CO) and Bill Bradley. These proposals would eliminate the program immediately. In addition, Senators Rick Santorum (R-PA) and Richard Lugar have introduced S. 1188, which would phase out the quota system by the year 2000. Ending the quota and allotment systems will benefit farmers directly by removing one of the most significant costs of production—rental of quotas—and ending the discrimination against U.S.-grown non-quota peanuts. Eliminating the unproductive overhead costs will increase the share of consumer expenditures returned to the producer

while, at the same time, increased domestic production of lower-cost peanuts will benefit the American consumer directly.

REFORMING THE DAIRY PROGRAM

The dairy program guarantees that the federal government will purchase, at an established price, unlimited quantities of surplus cheese, butter, and dried milk. The law provides a mechanism by which the guaranteed purchase price can be lowered or raised, depending upon whether the government's purchases are expected to exceed or fall short of a preestablished level. Under no circumstance, however, can the support price drop below a floor price of $10.10 per hundred pounds of milk.

When government guarantees that it will purchase any surplus production that cannot be sold in the marketplace, producers have no incentive to compete against each other. Thus, incentives for efficiency and innovation also disappear. Processors have no incentive to take the risks necessary to develop new products demanded by American and foreign consumers, so the industry is sluggish and unresponsive to the ever-changing demands of both domestic and international markets.

In addition, the nation's milk supply is regulated by an unbelievably complex and archaic system of federal milk marketing orders. Ostensibly designed to assure adequate supplies in all regions of the country, these marketing orders restrict the sale of milk between different regions. These pricing policies tend to raise the effective support price in high-cost regions of the country, encouraging farmers to increase production instead of permitting fluid milk to be shipped in profitably from lower cost regions. It is estimated that milk marketing orders cost consumers between $621 million and $851 billion in 1985 (in 1995 dollars, from $839 million to $1.15 billion).[6] The program has hindered the U.S. dairy industry's ability to take advantage of the export market. There should be no restrictions on where milk is sold or marketed and no government attempts to manipulate interstate commerce in dairy products.

However, the industry's reform proposal would make the situation even worse. The National Milk Producers Federation (NMPF) has outlined a proposal that would eliminate price supports for butter and powder. But it would retain price support for cheese, require the Secretary of Agriculture to buy about 2.4 billion pounds of dairy products, and mandate an increase in price supports, thereby further pushing up prices. By keeping the support price on cheese and requiring additional payments when lower world market-priced butter is used to produce other U.S. products, this proposal would insulate American dairy producers from the impact of eliminating price supports on butter and powder.

In effect, this proposal would establish a two-tiered pricing system with a lower export price on butter and nonfat dry milk and a higher domestic price on fluid milk and cheese. U.S. manufacturers of products which use nonfat dried milk would be required to pay a higher price for that ingredient than would foreign manufacturers us-

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6 Rachel Dardis and Bonnie Bedore, "Consumer and Welfare Losses from Milk Marketing Orders," *Journal of Consumer Affairs*, Winter 1990, pp. 366-380.

ing the same U.S. product. This amounts to imposing a "powder tax" on domestic manufacturers.

The expectation is that decoupling nonfat dry milk and butter from support prices would cause prices for these commodities to fall to world market levels and become competitive in international trade. However, requiring a higher price on nonfat dry milk and butter used as a domestic food ingredient would lead to a two-tier system for nonfat dry milk, with a higher price for domestic purposes than for international purposes. Ice cream, cheese, or confectionery manufacturers and bakers in the U.S. would be required to pay more for nonfat dry milk used to produce their products than would manufacturers in other countries using U.S.-made nonfat dry milk.

Such a two-tiered pricing system not only would violate the GATT agreement, but also would make it virtually impossible for U.S. manufacturers of value-added products to compete in the world market. This will discourage expansion of that increasingly important potential export market while providing even more barriers to entry for those who are not in the industry at the present time, further limiting growth in the domestic market where 98 percent of U.S. production is consumed.

The NMPF proposal also includes consolidating the 40 or so existing milk marketing orders into 8 to 12 market order areas. There have been other suggestions that existing federal and state milk market orders be consolidated into a single national order for all milk produced in the United States, thereby dramatically increasing the federal government's control over the marketing of milk. But consolidating milk marketing orders does nothing to reduce the federal government's involvement in and regulation of the dairy industry. In fact, mere consolidation will make the already unresponsive pricing system even less responsive to market forces.

Two recent proposals represent real reform. For a time, there was only the Dairy Freedom Act introduced by Representative Thomas Petri (R-WI), which would end the trade-restrictive marketing orders on January 1, 1996, and phase out the dairy support program over five years. More recently, however, Chairman Roberts has incorporated a dairy reform proposal by Representative Steve Gunderson (R-WI), Chairman of the Dairy Subcommittee. Similar to what Chairman Roberts has proposed for wheat, feed grains, cotton, and rice in the Freedom to Farm Act, Gunderson's proposal would eliminate the milk marketing orders' pricing and regulatory functions on July 1, 1996, and end the price support program on January 1, 1996, replacing it with transition payments to be made over the next seven years.

CONCLUSION

If the House and Senate Agriculture Committee Chairmen can overcome the entrenched special interests standing in the way of reform and report the Freedom to Farm Act out of their respective committees, their committees will be making history by setting the wheat, feed grain, cotton, and rice programs on the path to reform. However, the true test of sweeping, fundamental reform will come when Congress decides what to do with the sugar, peanut, and dairy programs. Incremental changes are not enough. Congress needs to adopt real reform of these programs: either outright elimination or reform comparable to what both Chairmen have proposed for the wheat, feed grain, cotton, and rice programs. By doing so, Congress will benefit

farmers and signal clearly to the rest of the world that the United States intends to pursue an aggressively pro-growth agricultural policy into the 21st century.[7]

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7 For a complete discussion of changes needed in the 1995 farm bill, see John E. Frydenlund, *Freeing America's Farmers: The Heritage Plan for Rural Prosperity* (Washington, D.C.: The Heritage Foundation, 1995).