



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington D.C. 20250



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REPLY TO

ATTN OF: 50601-14-KC

TO: Floyd D. Gaibler
Deputy Under Secretary
Farm and Foreign Agricultural Services

FROM: Robert W. Young
Assistant Inspector General
for Audit

SUBJECT: Interim Report on Peanut Price Discovery

This is an interim report on our audit to evaluate the processes used by the Farm Service Agency (FSA) for obtaining peanut market price data that are used to establish marketing assistance loan repayment rates and counter-cyclical payment rates¹ for peanuts. Specifically, we are providing you our assessment as to whether we could determine if the peanut price and volume data reported to the National Agricultural Statistics Service (NASS) and used by FSA in its price support programs are based on reliable market data. NASS collects farmer stock peanut prices and volumes from shellers and buying points (first handlers) through a survey. This information, by law,² is provided to NASS voluntarily, and NASS cannot release individually identifiable information without the express permission of the party reporting the information. This memorandum is to inform you that we are unable to provide assurance that the data reported to NASS are reliable because the first handlers denied us access to the records needed to validate pricing and volume information.

At our request, NASS contacted buyers/shellers³ who reported market data to NASS and requested that those first handlers allow OIG access to their records. NASS reported to us that the first handlers denied our request for access. Although we do not know specifically which first handlers NASS contacted, NASS informed us they contacted those buyers/shellers who buy a large volume of peanuts and cooperate with NASS in the weekly price surveys. We attempted other alternative methods to evaluate the reliability of the data reported to NASS and were not successful.

¹ Generally, the counter-cyclical payment rate is the difference between the target price established by law and the national average market price (based on pricing data collected by NASS from first handlers).

² Section 1770 of the Food Security Act of 1985, Title 7, United States Code § 2276.

³ Citing confidentiality reasons, NASS declined to identify the identity of the buyers and/or shellers it contacted.

Unlike other commodities for which the 2002 Farm Bill (Public Law 107-171) authorized price support, there is no cash or spot market or futures exchange for peanuts. Market power is concentrated among shellers who enter into private contracts with growers, often before planting. This leaves few alternatives to growers in marketing their peanuts, as well as limits available market price data for other interested parties. Moreover, a large portion of peanuts are marketed using option contracts.⁴ When a producer enters into an option contract with a sheller, the producer designates the sheller as its agent to redeem the producer's peanut production pledged as collateral for a specified marketing assistance loan. In effect, the price paid by the sheller is based on the FSA-determined loan repayment rate. A very high proportion of the crop moves through the loan program each year. For example, for the 2006 crop year, about 98 percent of the crop was placed under loan. Therefore, there are limited arms length price discovery alternatives available.

Pricing information collected by NASS is used by FSA to determine marketing assistance loan repayment rates and counter-cyclical payment rates for peanuts. Therefore, peanut market prices have a significant impact on those program payments. For crop years 2002 through 2006, producers obtained \$2.9 billion in peanut marketing assistance loans, but forfeited only \$53 million of these loans to the Commodity Credit Corporation. For that same time period, FSA issued over \$71 million in marketing loan gains, \$26 million in loan deficiency payments,⁵ and \$850 million in counter-cyclical payments for peanuts. Because of the complexities of the program, reporting errors can occur. We estimate that a \$0.01 change in the average peanut price per pound as determined by NASS would have affected total counter-cyclical payments by an average of over \$33 million a year. We could not readily estimate its potential impact on the marketing assistance loan program because of other considerations that FSA must consider in its determination of the loan repayment rate.⁶

It is our conclusion that without mandatory price reporting, we can provide no assurance that marketing assistance program or counter-cyclical payments for peanuts are based on reliable or supportable market price data. We believe that the Department should seek authority to verify reports filed by first handlers to ensure that data supplied to NASS are accurate and complete, and conform to the provisions of the price reporting instructions.

If you have any questions, or would like to discuss these issues, please do not hesitate to contact me at (202) 720-6945.

⁴ The option payment is a premium paid by a sheller to a producer, above the loan repayment rate, in exchange for the right to redeem the grower's marketing loan at a time of the sheller's choosing.

⁵ A producer receives a marketing loan gain when the repayment rate is lower than the loan rate. Alternatively, in lieu of securing a loan, the producer may elect to receive a loan deficiency payment, which is equivalent to the marketing loan gain.

⁶ The 2002 Farm Bill specifies that the loan repayment rate will (1) minimize potential loan forfeitures; (2) minimize the accumulation of stocks of peanuts by the Federal Government; (3) minimize the cost incurred by the Federal Government in storing peanuts; and (4) allow peanuts produced in the United States to be marketed freely and competitively, both domestically and internationally.