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Testimony of David Schemm
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Before The Senate Committee on Agriculture, Nutrition, and Forestry
"Commodities, Credit, and Crop Insurance: Perspectives on Risk Management Tools and Trends for the 2018 Farm Bill"
July 25, 2017

Chairman Roberts, Ranking Member Stabenow, and Members of the Committee, thank you for the opportunity to testify today. I'm David Schemm, the president of the National Association of Wheat Growers. I raise wheat, corn, and grain sorghum on my farm near Sharon Springs in western Kansas. Thank you for holding this hearing as part of a larger series of hearings to review programs ahead of the next Farm Bill reauthorization.

Wheat growers across the country have experienced a multitude of challenges the past couple of years, with unfair competition from countries like China that have support systems that distort trade and a dollar value that is relatively high making our wheat more expensive than other major wheat producing-countries, among others. Wheat prices have been on the decline for the past couple of years, and took a significant dive last year. Prices are at unreasonably low levels right now and are expected to remain low for the foreseeable future. A recent exception to this has been spring wheat on the Minneapolis Exchange. Unfortunately that's largely a result of a devastating drought that's hitting the Upper Great Plains and the resulting short harvest. Programs authorized in the Agricultural Act of 2014 (the Farm Bill), and the crop insurance program in particular, have been key tools to enable farmers to continue farming when prices collapse or disaster strikes.

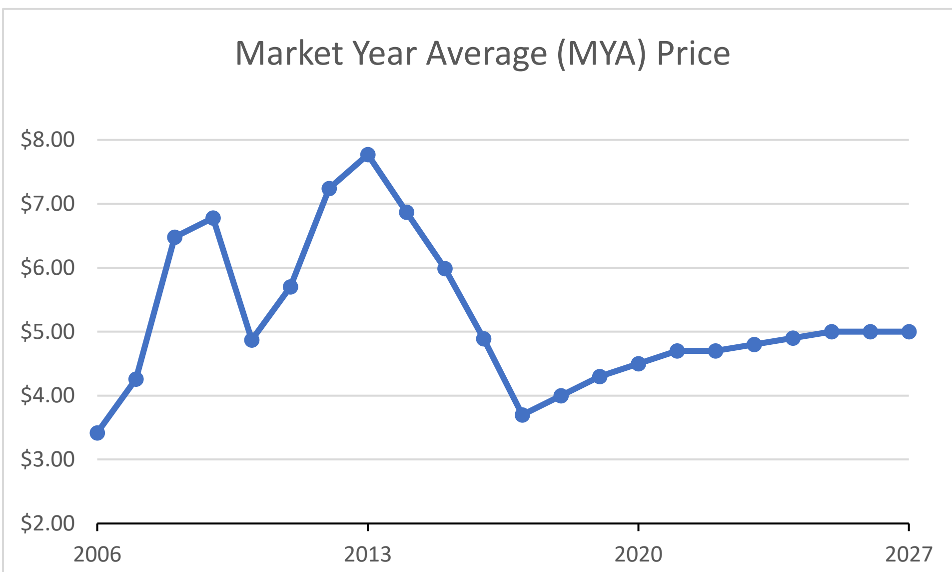
As the 2014 Farm Bill programs have been implemented, there have been some hiccups along the way. We've worked through them and have sought your help in influencing implementation, and we sincerely appreciate your help and attention to our concerns along the way. Despite those hiccups, the programs have been functioning as they were supposed to: as a safety net for producers. Through my testimony, I will highlight some key examples of how these programs have functioned effectively and some areas where tweaks would be helpful. Let me start by laying out the economic conditions in wheat country.

<u>Economic Conditions in Wheat Country</u>

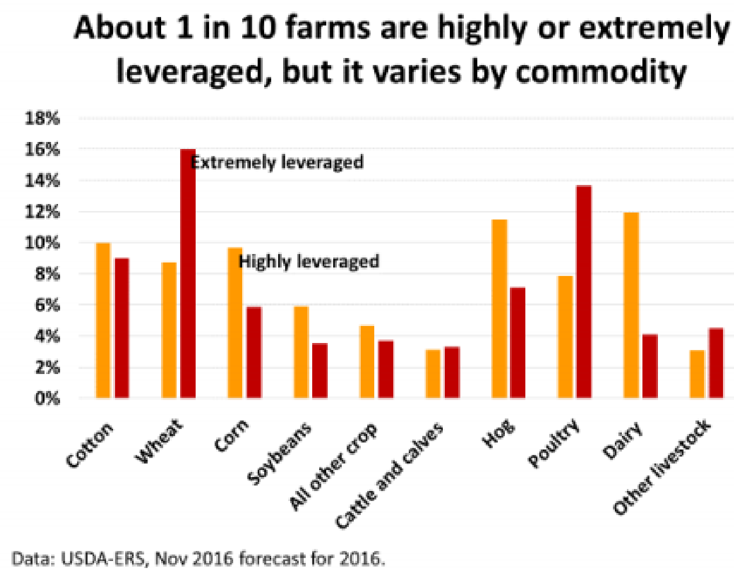
The past couple of years have proven to be particularly challenging for wheat farmers across the country. Farmers of most commodities are experiencing lower than normal prices. Wheat in particular has dipped to levels we haven't experienced in a long time. Producers of Hard Red Winter (HRW) wheat in my neck of the woods became eligible for marketing assistance loans (MALs) and Loan Deficiency Payments (LDPs) for the first time in several years because prices dropped below loan rates. When the last Farm Bill was written, loan rates were set at such a low level they were never expected to trigger. They have, but MALs and LDPs have functioned as helpful cash flow tools and have enabled farmers to hold onto their wheat until prices improved. Farmers have had to deal with a rapidly declining market, and months and years of sustained low prices that will make each passing year more difficult to get by, particularly for young and beginning farmers who couldn't build up reserves during the high price years. This is particularly relevant as the average age of a farmer is 58 and is expected to continue climbing.

There have been many different factors that have contributed to the low prices, which I will discuss throughout my testimony. One particularly important factor has been market competition from other large wheat-producing countries. Though this falls outside the scope of Title 1, I strongly believe that Congress needs to continue to aggressively pursue new markets. Along those lines, NAWG supports reauthorizing and doubling funding for the Market Access Program (MAP) and Foreign Market Development (FMD) program as part of the next Farm Bill. A study last year from Informa Economics showed that from 1977 to 2014, for every dollar spend on MAP and FMD, there was a return on investment of $28.20 in export gains. Additionally, these programs were responsible for 15 percent of total agricultural export revenue, and they have increased net farm income by $2.1 billion annually, on average. These programs work, and the value of them can be greatly expanded with additional investment.

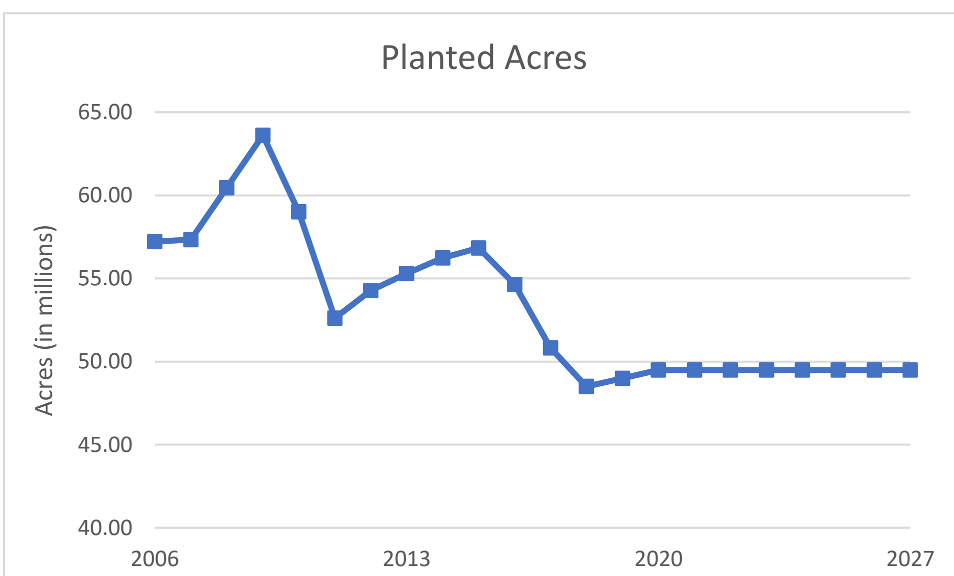
As the chart below laying out the market year average price shows, there have been some big swings over the past few years and more recently there have been significant drops in prices; the market year average price is determined by USDA and is used in setting farm program and crop insurance payments. Additionally, as I'll discuss later in my testimony, the price that farmers are actually receiving from their local elevators is often much lower than what the market year average price would show.



The data in the above chart for 2006 through 2015 shows Market Year Average Price from USDA National Agricultural Statistics Service (NASS), and from 2016 through 2027 shows the assumptions made by the Congressional Budget Office (CBO) for future Market Year Average prices. The low prices have led to farmers needing to take on more debt to continue operating. As such, producers' debt to asset ratios have grown rapidly. The chart below lays out the degree to which producers have taken on debt. Over 8 percent of wheat producers are considered by USDA's Economic Research Service to be "highly leveraged" (a debt-to asset ratio between .4-.69) and 16 percent are considered to be "extremely leveraged" (a debt-to-asset ratio over .69).



The economic conditions of the past few years have also contributed to a drop in planted wheat acreage, which is predicted to continue. Plantings for the 2016-2017 crop year is down 9 percent from the previous year and is the lowest planted acres on record since records began in 1919. The 2017 winter wheat planted acres was 32.8 million, down 9 percent from 2016. The area planted to spring wheat is estimated at 10.9 million acres, down 6 percent from 2016. Not only are planted acres down, but given widespread weather issues (late freeze, blizzard, drought, and other problems), production will be down as well.



The chart above shows the 2006-2016 actual planted acres, as published by USDA's NASS. The 2017-2027 data points show the anticipated future plantings of wheat as published in the June 2017 CBO baseline report. CBO anticipates that there will be a small swing back up in acreage, but this still exemplifies the challenging conditions facing growers when they pull back their production and shift to other crops.

<u>Title 1 – ARC and PLC</u>

In addition to crop insurance, which I'll discuss later in my testimony, the Title 1 programs like Agriculture Risk Coverage (ARC) and Price Loss Coverage (PLC) have served as key safety net programs that are limited, and kick in for losses not covered by crop insurance.

With the reform of the safety net programs in the last Farm Bill away from direct payments to a choice between revenue protection and price protection, implementation has gone relatively smoothly and those programs have largely functioned as they were intended. There have been some hiccups along the way, and we envision several tweaks that could be made to make these programs even more effective.

Agriculture Risk Coverage Program

Wheat is grown in 42 states with very different growing conditions, and thus have different protection needs across the country. Some areas of the country experience more production variability than other areas of the country; therefore, we need to maintain revenue protection through the ARC program.

The majority of wheat base acres were enrolled in ARC-County. This program has worked well, but we have experienced several significant issues the past couple of years. Additionally, as prices continue to remain at low levels, the effectiveness of this program will decline as low prices are factored into the benchmark. Some tweaks could be made to ARC to ensure it continues to be a viable option for producers.

One option could be to increase the reference price in the ARC formula to be consistent with whatever final PLC reference price is established and use that price as a floor for setting benchmark guarantees. With the anticipation that market prices will remain at historically low levels for the foreseeable future, we urge Congress to ensure that a mechanism is in place to maintain an appropriate benchmark revenue guarantee to help farmers through these difficult times.

On the yield side of the equation, counties that experience highly variable yields from year to year, or that experience multiple years of significant drought or some other weather event, will experience significant drops in their ARC guarantee. An option that should be considered would be to cap the percentage drop in yield in any given year for the guarantee by increasing the transition yield (T-yield) that is used when a county's yield drops below a certain level. An option could be to extend the number of years that are used in setting the benchmark to smooth out the dramatic changes in yields over that timeframe.

Our producers have concern about the data that is used in the ARC program, and we believe that, where available, data from the Risk Management Agency (RMA) should be the highest priority data source that's used to set yields. As it stands now, FSA uses data through the National Agricultural Statistics Service (NASS), which is based on voluntary producer surveys. If NASS is unable to publish a yield, FSA will then utilize a cascade of other data sources. Over several years, it's certainly possible that a particular county could have a couple of years with NASS published data and a couple of years without published data because of a lack of survey responses. Without a published NASS yield, FSA would then use data from another source to set those yields. This is like comparing apples to oranges when using multiple data sources. Instead, the information that a producer reports to RMA for purposes of purchasing crop insurance is mandatory, and we believe appropriate county yields can be pulled from that information. We recognize that there will still be disparities in payment rates between counties, but utilizing more reliable data will help to instill more confidence in our producers that they are getting fair treatment from the program.

Wheat is grown in very rural areas, and in some cases there are very large counties where there is significantly different growing conditions from one end of the county to another. Farmers rightly had the option of enrolling in ARC-Individual, but as a farmer would have to experience a greater loss than under ARC-County and as it would only apply on up to 65 percent of a participants' base acres, the program was much less attractive than ARC-County. An approach that could be taken to improve the functionality of ARC-County in large counties would be to use smaller than county size geographic areas in particularly large counties that experience weather and growing variations for establishing payment rates. This approach could enable payments to be triggered at a more localized level and to be more reactive to the actual experience of producers.

Price Loss Coverage

Wheat farmers enrolled roughly 43.5 percent of the wheat base acres across the country into PLC. The recent Congressional Budget Office (CBO) baseline report, in projecting the costs of USDA programs over the next ten years, assumes that Congress will allow for a producer re-election after the expiration of the current Farm Bill and that roughly 80 percent of base acres will be enrolled in PLC. This is anticipated as lower prices of the past couple of years will begin to be incorporated into the ARC benchmark, ultimately reducing the benchmark revenue.

From our perspective, this means that it will be important to adjust the ARC formula to enable it to continue to function as a safety net when the need is there. It also means we need to ensure that PLC reference price is set at a level that provides a sufficient safety net when prices are at perpetually low levels.

While PLC has kicked in for producers that enrolled, the current reference price for wheat of $5.50 per bushel is far below the cost of production. We urge you to increase the wheat reference price that is more closely reflective of the modern cost of producing the crop. As such, we think the PLC wheat reference price should be set at a level that is closer to $7 a bushel to truly enable PLC to function as a safety net for farmers when times are tough, like they are today.

Marketing Loan Program

Last year, the Marketing Assistance Loan (MAL) program and Loan Deficiency Program (LDP) trigger for the first time in many years for Hard Red Winter (HRW) wheat producers. The Farm Bill sets statutory loan rates, ultimately meaning that the loan rates at the county level across the country have to average out to the rate set in statute. The loan rate for wheat was set at $2.96 per bushel in the last Farm Bill, and so some counties had rates lower and higher than that level to trigger the availability of MALs and LDPs. We haven't had to imagine prices dropping that low in a long time, but they did for an extended period last year. MALs and LDPs served an important role to help farmers, including my own operation, hold onto their crop until prices improved. These programs actually have relatively little cost to the government, as they are loans that farmers pay back when they do eventually sell their crop on the market. This program should be continued, and the loan rates should be increased to better reflect modern production costs and more recent price realities.

Other Title 1 Issues

In setting up a national program, it's unrealistic to establish a one-size-fits-all approach that will ensure sufficient protection for all growers. As such, we urge Congress to continue to allow a producer choice between revenue protection and price protection. With growing and marketing conditions that can vary across the country, maintaining a choice in programs is critical. Additionally, we support allowing a one-time re-election of programs at the beginning of the next Farm Bill, as well as any time at which any substantial program changes occur.

NAWG also believes that the next Farm Bill should continue the use of base acres rather than planted acres in determining farm program payments. Additionally, should you make any changes to the structure of the base acre program, we urge you to give farmers the choice as to whether to update their base rather than making it mandatory.

And finally, for both ARC and PLC, NAWG opposes any further restrictions to farm program eligibility in terms of "actively engaged" requirements. We also oppose any further tightening of payment limitations.

Crop Insurance

The federal crop insurance program has been and continues to be farmer's most important risk management tool. The program requires a farmer to pay a premium, the cost of which is shared with the federal government, and is structured in a way that the producer has to suffer an indemnifiable loss before they get any sort of payment. A farmer might go many years paying premiums for a policy and rarely get an indemnity. A farmer would much rather get a return on their commodity than becoming eligible for an indemnity.

The ability to manage risk through crop insurance is very popular with producers. For the 2015 crop year, there were 56.8 million acres of wheat grown in the United States (according to USDA's Economic Research Service (ERS)), of which 49.4 million acres (or 87 percent) were insured (according to USDA's Risk Management Agency Summary of Business document, as of March 20, 2017). This high participation rate is indicative of the effectiveness of the program.

The last couple of years have been particularly difficult for wheat farmers. Crop insurance has played an important role in helping producers get through the current low prices. Each year there will inevitably be producers in some part of the country that experience weather conditions outside of their control that could take out their crop. This year, in my parts of Kansas alone, we experienced a late-season blizzard, a freeze, hail and disease. Currently, South Dakota, North Dakota, and Montana are experiencing drought that's taken out much of their spring wheat crop. On the other spectrum, North Carolina experienced flooding last year that had a widespread impact on their wheat crop. Crop insurance is critically important to enable a producer to farm another year after an uncontrollable weather or disease event. As my fellow Kansas wheat farmer, Ken Wood, said to this Committee at your recent field hearing, "for most of us, crop insurance will not guarantee a 'good year,' but it offers the promise of 'another year.'"

NAWG opposes any efforts that would undermine the current structure of the program. Specifically, we oppose any restrictions on eligibility for program participation based on a producer's Adjusted Gross Income, any caps on the federal cost-share level, and any restrictions on a producer's ability to utilize the Harvest Price Option (HPO). Restrictions on eligibility would cause farmers to lower their crop insurance participation which would not only cause the producer to take on more risk, but it would also cause premiums for all producers, big and small, to increase. If producers lower their coverage or if fewer producers are participating, that means there are fewer acres over which to spread risk in the program, ultimately requiring premiums to increase.

In addition to supporting the current structure of the producer support component of crop insurance, NAWG opposes any cuts to the delivery system. The current public-private partnership for program delivery to producers has worked very well and has ensured that producers can get timely assistance when economic or weather disasters strike. Efforts to reduce the target rate of return or Administrative and Operating (A&O) reimbursements would negatively affect crop insurance companies and their ability to deliver programs, and would thus have a negative impact on producers. The federal crop insurance program has also performed incredibly well, with an improper payment rate of just 2.2 percent, which is about half the government-wide average of 4.39 percent. Additionally, RMA has an effective data mining system to detect and combat fraud. NAWG urges you to exclude any of these types of proposals.

With all this said, wheat producers have experienced a few issues over the past couple of years that warrant discussion.

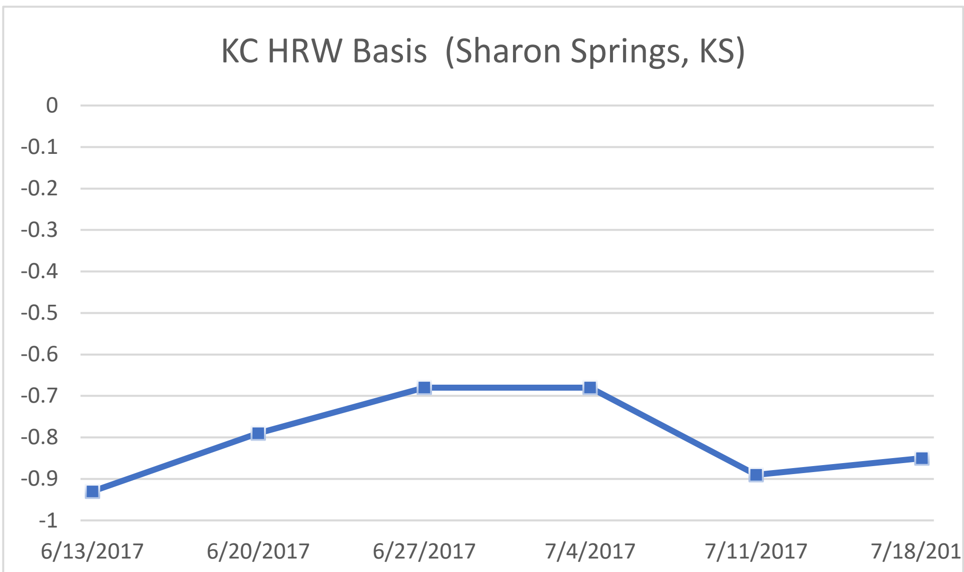
Yield Exclusion
NAWG was very supportive of the inclusion of the Yield Exclusion provision as part of the last Farm Bill. When the Farm Bill was being written, many producers were suffering periods of prolonged drought. The Yield Exclusion provision enables producers in a county that had yields with a 50 percent or greater hit to be able to exclude that year's yield from their Actual Production History. We were, however, disappointed that USDA was unable to implement this provision for the 2015 winter wheat crop. Members of the Senate Agriculture Committee were champions of wheat during that timeframe, raising this issue with USDA officials. Though the Department was still unwilling to have the provision apply to that year's crop, the Committee's attention to this issue undoubtedly drove USDA to quickly move forward with implementation for spring-seeded crops that year and subsequently the 2016 winter wheat crop. I will note that while we are strongly supportive of YE, a disincentive to participate is that the use of YE ordinarily means that premium rates will increase for that producer.

Non-convergence in the HRW futures market
I'm a Hard Red Winter (HRW) wheat producer in western Kansas. Last year, our planted acres were down but we still had a crop that exceeded our previous yield record by over 10 bushels per acre. We had a much bigger crop than expected. This had a lot of implications for the markets. Where were we going to not only ship our wheat, but where were we going to store it in the interim? There were and continue to be significant logistical issues associate with the huge crop. This was just exacerbated by big crops in other significant wheat-producing countries, like Russia which was the largest producer last year. We had significant competition in our export markets from other countries whose wheat was relatively less expensive than U.S. wheat in part because of the relatively high value of the U.S. dollar. These economic forces have been part of the cause of the depressed prices.

At harvest time, as is the case for any crop, there is generally immediate downward pressure on prices because everyone is delivering to the market right from the field at the same time. So, we'll often experience a growing divergence in the local cash price as compared to the futures market; the difference is referred to as the basis. Producers of HRW experienced a much wider basis than what we've experience in a long time. Personally, my local basis jumped from $.70 a bushel to $1.55 a bushel in just ten days. Fortunately, the CME group has stated it plans to implement variable storage rate for

Kansas City Hard Red Winter Wheat futures contracts starting next spring. We think this will have a positive impact on the market and provide an incentive for more movement of product.

Even with this, there are several potential crop insurance implications of non-convergence that you should be made aware of here. For HRW producers with revenue coverage, their contract is based on the Kansas City futures price. When the local cash price was $1.55 below the futures price, had I sold the crop and tried to pursue an indemnity, my contract would've only reflected that I was receiving the futures price rather than the actual price. My "actual" revenue was significantly inflated compared to my real experience. There are potentially similar implications for the ARC program, in that the ARC formula utilizes a market year average price, which wouldn't account for farmers experiencing a wide basis. The graph below shows the basis between Kansas City Hard Red Winter September 2017 futures contracts and the cash price received at an elevator in Sharon Springs, Kansas over the past month and shows there currently a basis of nearly $.90.



NAWG has been exploring this issue to identify whether there are components of the crop insurance program that can be adjusted to make the program more reactive to what the farmer is getting paid for their crop. As we continue with this process, I will keep in touch with you and the rest of the committee.

Quality Adjustments

Our wheat markets set strict standards for quality. Wheat tends to be more susceptible to quality problems than many other commodities. There are technologies in place to assist producers in producing the best quality of wheat anywhere in the world, but we are still dependent upon favorable growing conditions. Recently, two of the higher-profile issues our growers experienced were low Falling Numbers in the Pacific Northwest and vomitoxin in the northern Plains.

Many producers have suffered from widespread financial losses due to weather-induced problems resulting in poor end-use quality as measured by low Hagberg-Perten Falling Numbers. The Falling Number test detects starch degradation due to alpha-amylase enzyme activity and possibly other factors in wheat flour. This ultimately indicates that the flour has poorer quality for baked goods. Farmers experiencing low Falling Numbers will likely receive a discount at their elevator, often significant depending on the degree to which their load was affected. Additionally, with low Falling Numbers, though the quality has taken a hit, it isn't a yield issue. In fact, the producers in Washington, Idaho, and Oregon that experienced this problem had bigger than average yields. However, the way the statue is written, those quality discounts are applied to a producer's Actual Production History (APH); even though low Falling Numbers doesn't directly affect a producer's yield, RMA still requires that their yield be reduced to reflect that quality loss. This occurs even if the producer doesn't pursue an indemnity. From a fairness standpoint, it would be worth considering whether such quality discounts could be applied to the price side of the equation rather than the yield side so that a producer's APH isn't affected for 10 years until that year's yield is cycled out.

Conservation Compliance

NAWG remains concerned about linking conservation compliance to crop insurance. The changes that were made during the last farm bill added stress to a system that was already overloaded. The backlog of wetland determination in the Prairie Pothole region still exists. NAWG appreciates that the Natural Resources Conservation Service (NRCS) reaffirmed their process for certain wetland determinations earlier this year and we believe that farmers that went through the process to obtain a determination in accordance with the Farm Bill provisions should not be required to go through another evaluation or re-determination.

Agricultural Credit

Recent price conditions have made farm loan programs more and more important. Fortunately, interest rates have remained relatively low, particularly as compared to interest rates during the 1980s farm crisis. We have a very effective system in place now where farmers have a number of options for securing financing. Farmers should continue to have access to commercial banks, community banks, and Farm Credit institutions.

Given the tough economic conditions in recent years, there has been an uptick in demand for FSA's direct and guaranteed farm ownership and operating loans. These programs have been important sources of financing for young and beginning farmers as well as for those producers who have been unable to secure traditional financing. Last year, demand exceeded lending authority before the end of the fiscal year, which meant many farmers had to wait before they could access critical loans. We urge you to include language in the Farm Bill that would ensure demand can be fully met, no matter the economic conditions in any given year.

An issue that we expect to get more and more attention the longer prices remain low is the ability to predict and incorporate a producers' farm program payments into their cash flow for purposes of securing financing. Assistance through Title 1 programs has become a more and more important factor for producers, particularly young and beginning farmers who haven't built up capital. As payments don't go out until over a year after the wheat crop has been harvested, it's difficult to predict what the payment rate will be, and it's even more difficult for financial institutions to justify anticipated payment rates to their regulators. We recognize that moving up the timing of payments would be cost-prohibitive; however, we think Congress should explore options for enabling better predictability.

Other Key Farm Bill Programs

Though this hearing focuses on commodities, risk management, and credit issues affecting agricultural operations, I'd like to take this opportunity to address a few other important programs. Wheat growers are focused on productivity and profitability and an important element of maintaining both productivity and profitability is managing our operations for long term success, managing productive healthy soils and being good stewards of the land. For a farmer, without a successful crop each year and our long term financial viability, we cannot purchase new equipment, test new practices and experiment with new cropping systems. We don't operate on margins that allow us to take the risk of an unsuccessful crop. Farm Bill Conservation programs provide a backstop that allows us to make investments in new technology and try new conservation practices.

NAWG supports the continuation of voluntary, incentive-based conservation programs in the next Farm Bill. NAWG members have prioritized working lands conservation programs in our discussions about the next Farm Bill. We believe these programs should work with farmers to integrate conservation practices and techniques into their farming operation. Part of that conservation assistance may be a buffer or filter strip, and these practices should be taken into consideration across the entire farming operation. There must be balance in the types of programs offered and flexibility to meet local needs. Conservation programs should provide a variety of types of assistance to producers, and recognize the different needs in different parts of the country and for different crop rotations.

The Conservation Stewardship Program (CSP) helps producers adopt conservation practices across their operations. Wheat growers have been participating in the program and have integrated practices and enhancements such as variable rate application of nutrients, replacing spray nozzles to control crop protection tool application, converting to direct seeding/no till farming, irrigation water management, and stalk testing for appropriate fertilizer application. NAWG members support continuation of CSP and allowing additional opportunities to enroll in CSP and would like to allow for an additional contract renewal. The financial incentive payments provided by CSP help producers off-set the cost of adopting a new practice, purchasing new equipment and providing habitat. These practices improve soil health, improve water quality, result in more efficient irrigation water use and benefit wildlife.

The Environmental Quality Incentives Program (EQIP) is another conservation program that is important to wheat growers. EQIP provides financial incentives for growers to undertake a certain conservation practice and provides for a shorter-term contract. EQIP also helps those producers that aren't quite ready for CSP. EQIP allows them to work toward meeting the requirements for eligibility in CSP. EQIP also provides assistance to producers seeking to undertake a specific conservation project on their operation. Farm Bill Conservation Programs have also been used to help producers comply with regulations. Specifically, EQIP provides assistance for producers to come into compliance with requirements of the Spill Prevention, Control, and Countermeasure regulations for on-farm fuel storage. Conservation programs also help producers meet requirements under federal and state water quality regulations.

NAWG members are very supportive of Farm Bill Conservation Program and we encourage the committee to retain the variety of conservation programs the Farm Bill offers. Cropping systems, climate, and soils are different across the country for all of our wheat farmer members, and our conservation programs need to be able to help farmers manage their resources in a manner that is specific to their cropping and resource needs. Working lands programs are the most beneficial in helping growers manage their operations to address natural resource concerns and maintain a viable crop. The working lands programs, such as CSP and EQIP, should be balanced with CRP that can also play an integral part of a conservation plan on a farmer's operation.

<u>Conclusion</u>

Wheat farmers across the nation are experiencing the toughest economic conditions they have faced since the 1980s and many of the previously mentioned projections don't show potential for a quick upturn in the farm economy. This next Farm Bill will be critically important to farmers. The political and policy dynamics facing Congress this year are much different than the process to write the last Farm Bill. A strong safety net and risk management system is needed now more than ever. Each year, farmers face unpredictable risk when they plant crops in the ground and they rely on an effective risk management system and safety net to offset the inevitable weather disaster or price drop. Crop insurance and Title 1 programs have proven to be effective and good policy in general.

As our discussions continue with what the next Farm Bill will look like, I look forward to working with you. I also encourage you to move quickly in this process to ensure a full reauthorization bill can be completed prior to the expiration of the current Farm Bill on September 30, 2018 so that producers have certainty about the structure of the safety net moving forward.

With that, I'll be happy to answer any questions.