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Before the Committee on Agriculture, Nutrition, and Forestry
United States Senate
March 14, 2012

Risks Facing America's Farmers and Ranchers

Chairwoman Stabenow, Senator Roberts, thank you very much for the opportunity to speak to you today on risk management and commodity programs in light of the 2012 Farm Bill.

Currently, agriculture is a bright spot in our economy, contributing one in every twelve jobs in America. Record high crop prices are providing great opportunities and have resulted in record income for farmers, falling farm debt, and growth in farm equity. However, agriculture also faces new challenges and pressures. Our farmers and ranchers today are faced with two primary risks as they produce our food: price volatility and production losses due to natural disasters or pests.

Price volatility in both commodities and inputs has become a major factor impacting producers. For the 2007-11 crop years, the price received for corn averaged $4.63 per bushel, ranging from a low of $3.55 for the 2009/10 crop to a projected high of $6.20 for the 2011/12 crop. The all-milk price averaged $17.42 per cwt. during 2007-11, reaching a low on $12.93 in 2009 and a high of $20.14 in 2011. The prices of inputs have also exhibited considerable variability in recent years. For example, the price paid for diesel fuel averaged $2.76 per gallon during 2007-11, ranging from a low of $1.69 in 2009 to a high of $3.62 in 2008, only slightly above last year's $3.53.

While crop prices have been very strong recently, the cost of production has also increased, with high input costs making it more costly to farm. For example, the average variable cost to plant and harvest an acre of corn has doubled in nominal terms between 1997 and 2011, and increased by over 80 percent for cotton. These high input costs increase the financial risk involved in agricultural production, and further underscore the need for a strong safety net.

No industry's success or failure is more closely tied to the weather than food production. In the past year we have seen crops fail due to lack of rainfall, too much rainfall, blizzards, fire, and heavy flooding that both destroyed crops and prevented planting. Because of the uncertainty that price volatility and unexpected natural disasters creates for producers, maintaining a strong safety net is as important today as it has ever been.

Results from 2008 Farm Bill

The programs included in the 2008 Farm Bill create a safety net that has provided significant risk protection for our farmers and ranchers. I would like to provide an overview of these programs and share some recent examples that demonstrate how the various parts of our current safety net - including disaster payments, commodity support programs, crop insurance, and farm credit - have helped producers manage the risk and uncertainty associated with producing food.

Disaster Programs
Five new disaster programs, administered by the Farm Services Agency (FSA), were included in the 2008 Farm Bill – the Supplemental Revenue Assistance Payments Program (SURE), Livestock Forage Program (LFP), Livestock Indemnity Program (LIP), Emergency Assistance for Livestock, Honeybees, and Farm-Raised Fish Program (ELAP), and Tree Assistance Program (TAP). In total, these programs have paid more than $3.8 billion to more than 200,000 producers from program inception.

In 2008, producers in Texas suffered significant losses due to drought, while producers in North Dakota and Iowa suffered losses due to too much moisture. This past year, several states along the East Coast were affected by Hurricane Irene and Tropical Storm Lee. The SURE program provided producers in these states, as well as many nationwide, with significant assistance for their losses as they recover from natural disaster. SURE has paid more than $3 billion to producers in over thirty states. Major recipient states include Texas ($450 million), North Dakota ($381 million), and Iowa ($328 million). Although these states have been key beneficiaries, some recipient states, such as Vermont, New Hampshire, and New Mexico, are not significant producers of major program crops and for them disaster assistance is virtually the only form of federal agricultural aid available to producers.

During 2011, widespread drought impacted producers in many states, particularly Oklahoma, Kansas, New Mexico, and Texas. Dry conditions forced many ranchers to either reduce or liquidate livestock herds or purchase hay. LFP provided significant immediate assistance to many of these ranchers suffering from drought. LFP payments, which have totaled more than $550 million since program inception, are based upon the U.S. Drought Monitor. Payments can be made within weeks of a qualifying drought.

During the spring of 2009, severe blizzards and winter storms hit parts of the Northern Plains causing substantial livestock deaths. LIP provided assistance to producers who lost livestock due to such natural disasters, allowing them to rebuild livestock herds quickly. LIP has paid out $144 million from program inception with North and South Dakota accounting for 40 percent of total outlays.

Due to Colony Collapse Disorder (CCD), many beekeepers have suffered significant losses in recent years. ELAP covers producers of aquaculture, bees, and other species. ELAP provides funds for losses that are not covered by other disaster programs, and has paid out $31 million from program inception. It has provided substantial assistance to beekeepers whose bees have suffered from CCD.

In August 2008, Tropical Storm Fay hit the Florida Keys causing substantial damage. TAP, which provides assistance for tree death losses, provided $2.1 million to Florida producers who suffered fruit and nut tree, bushes, and vine damage. Nationwide, TAP has paid nearly $14 million from program inception. TAP and ELAP often provide assistance to producers who may not have access to federal crop insurance, and are critical in this era of widely varying weather events.

These five disaster programs expired on September 30, 2011. As of today, the only FSA

program currently providing disaster assistance coverage is the Noninsured Crop Disaster Assistance Program (NAP). NAP provides financial assistance to producers where crop insurance is not available and when low yields, loss of inventory, or prevented planting occur due to natural disasters. NAP payments are typically less than $100 million annually.

Commodity Support Programs

In the spring of 2009, extended dryness and an early April freeze caused significant losses for wheat producers in Oklahoma and parts of Kansas. The Average Crop Revenue Election (ACRE) program, first authorized by the 2008 Farm Bill, provided approximately $90 million to wheat producers in Oklahoma to help compensate for lost 2009 revenue. ACRE payments are made based on revenue risk, rather than just price risk, and require that both state- and farm-level triggers be met before a producer receives a payment. Because it is an alternative to traditional programs, an ACRE participant forgoes counter-cyclical payments and realizes a 20 percent reduction in direct payments and a 30 percent reduction in marketing assistance loan rates for all commodities on the ACRE-enrolled farm. Once a farm is enrolled in ACRE, that farm is required to stay enrolled in ACRE through 2012. ACRE participation accounted for 14 percent of base acres across all crops in 2011. Participation for 2011 crops is strongest for corn (16 percent of base), soybeans (16 percent) and wheat (14 percent). The bulk of enrollment occurred in 2009, the first year of the program.

ACRE payments have varied significantly across locations and years. For the 2009 crop year, about $430 million in ACRE payments were made, by far the highest payout year. Wheat producers accounted for about $300 million of that total.

With high market prices for program crops in recent years, Counter Cyclical Program (CCP) payments have been modest, with only producers with peanut base benefitting in fiscal year (FY) 2011. Prices can shift dramatically, however, even within a short time period. For example, cotton farmers received $1.2 billion in CCPs for the 2008 crop, as cotton prices were severely depressed in the aftermath of the financial crisis and in the face of large cotton stocks. Variable production costs per acre were $444, compared to a production value of $492, leaving little room for any return for the operator in the absence of government assistance. No CCPs are expected for the 2011 and 2012 crops. In comparison, CCP totaled $4.4 billion in FY 2006 and $3.2 billion in FY 2007, when market prices averaged significantly lower.

Similar to the situation for CCPs, high crop prices have greatly reduced marketing loan benefits, which are expected to total less than $2 million in FY 2012. Now, one of the key benefits of marketing assistance loans is the interim financing provided to farmers that help them with their cash flow needs. The value of loans made is estimated to total about $7 billion in FY 2012.

Dairy producers have also weathered extremely volatile conditions in recent years. During 2009 dairy producers suffered significant losses. In 2009, the all-milk price dropped to $11.30 per hundredweight, the lowest since 2003. Over $938 million was paid directly to milk producers under the Milk Income Loss Contract (MILC) program for February through November 2009 production and April 2010 production. The MILC is a price-based, counter-cyclical payment program for dairy producers that includes a “feed cost adjuster” that increases the size of the payment depending on ration costs. Feed costs are currently at very high levels and, with dairy

prices declining, MILC payments are expected to total $180 million in FY 2012, starting with February production. These are the first MILC payments to be paid to dairy producers since April 2010. The authority for MILC payments ends on September 30, 2012.

Unlike the other safety net programs, the sugar program is designed to operate at no net cost to the federal government. Since the 2008 Farm Bill, sugar prices have stayed considerably above support levels and no sugar program costs have been incurred by the Commodity Credit Corporation.

Credit
For some producers, particularly beginning farmers and ranchers, FSA's credit programs are a critical piece of the safety net. Over the last few years, many farmers have struggled to obtain credit due to tight credit markets resulting from the financial crisis. In early FY 2009, loan demand surged to levels that had not been seen since the early 1980s. Demand for farm loan program assistance in FY 2009 and FY 2010 reached its highest levels since FY 1985. Use of the guaranteed farm ownership program in FY 2010 reached an all-time high, and direct operating and farm ownership obligations nearly doubled compared to FY 2008 levels.

An unusually high number of direct operating loan applications have been received from new customers since FY 2009. Historically, about 20 percent of direct operating loan applications in any given year are from farmers who do not already have FSA loans. Since 2009, that number has increased to over 40 percent. Further, FSA lending programs provide substantial leverage of federal resources. For FY 2012, $108 million in budget authority will allow the agency to make almost $4.8 billion in direct and guaranteed loans.

The surge in loan volume and dramatic rise in "first-time" borrowers are two indicators of the important safety net role played by FSA direct and guaranteed loans. A third indicator of this important role, and perhaps the most important, is the fact that delinquency rates and loan losses on FSA direct loans remains at historically low levels. In fact, currently over 95 percent of our direct loan borrowers are paying their loans on time despite being told by their home town bankers that they are too risky for the bank to loan them money. Without this important safety net these creditworthy farmers and ranchers would be unable to obtain the credit necessary to maintain their operations.

Crop Insurance
The Federal Crop Insurance Program, administered by the Risk Management Agency (RMA), is the primary risk management program available to our Nation's agricultural producers and a vital component of the farm safety net, addressing both the risks associated with price volatility and with unexpected disasters. It provides risk management tools that are compatible with international trade commitments, creates products and services that are actuarially sound and market driven, harnesses the strengths of both the public and private sectors, and reflects the diversity of the agricultural sector. The Federal Crop Insurance Program provided more than $113 billion in risk protection on over a million policies covering 264 million acres in crop year 2011. Reflecting extensive crop losses, the program has paid out over $10 billion in claims for lost revenue or damaged crops.

Producers generally have a choice of crop policies with coverage that they can tailor to best fit their risk management needs. For major crops, producers can buy subsidized insurance coverage for a yield-only loss, or revenue protection to provide coverage against a decline in yield or price. Today, almost 93 percent of the acreage in the program is insured at “buy up” levels of coverage that range from 50 percent up to 85 percent. A small amount of business is still insured at the catastrophic level of coverage for which premiums are fully subsidized. Indemnity payments are usually made within 30 days after the producer signs the claim form.

To ensure that our programs are best tailored to the needs of a diverse set of producers, RMA works closely with private entities under authority provided under section 508(h) of the Federal Crop Insurance Act. Over the past two years, the Federal Crop Insurance Corporation (FCIC) Board of Directors (Board) has approved product submissions that are covering an increasing variety of commodities. For example, work in conjunction with producer groups around the country resulted in new programs or modifications to existing programs, including: Louisiana Fresh and Processing Sweet Potato program; Trend-Adjusted Actual Production History (APH); APH-Olives; Popcorn Revenue insurance; Specialty-Trait Soybeans; Texas Citrus Tree policy enhancements; and Annual Forage.

Also at the request of growers, RMA combined the Plum Crop Insurance Provisions and the Stonefruit Crop Insurance Provisions to expand insurance availability for plums to additional states such as Idaho, Oregon and Washington. In 2010, changes were made to the Sunflower policy to provide optional units by type, specifically allowing farmers to have separate optional units for their oil and non-oil sunflowers. In addition, Buckwheat insurance coverage was made available to producers in selected counties in Minnesota, North Dakota and Washington.

In 2010 we also made significant revisions to livestock gross margin insurance (LGM) for dairy producers to make participation more attractive. These changes, which included moving the premium billing date to the end of the insurance period and providing graduated producer premium subsidies, caused a surge in sales. RMA revised the funding allocation for LGM-Dairy, eventually making about $16 million in underwriting capacity available for the product. This funding was exhausted in March of 2011 and sales were suspended until October 2011. Before the 2011 reinsurance year, expenditures for all livestock products combined had never approached $5 million in any one year.

With the beginning of a new fiscal year in October 2011, new funding became available and sales of LGM-Dairy began anew. However, in January 2012, RMA ended further sales of LGM Dairy for FY 2012 to ensure that some funding remains available to facilitate sales of the seven other livestock insurance plans. Funding for livestock insurance products is currently capped by the Federal Crop Insurance Act at $20 million in any fiscal year.

To address concerns raised by ranchers, the FCIC Board approved the expansion of the Rainfall Index and Vegetation Index Pasture, Rangeland, and Forage program and the Apiculture program into several states. In addition, RMA has worked with the Precision Agriculture Industry to expand the use of precision agriculture by allowing producers to use their acreage and yield to monitor records in conjunction with other precision farming records to separate and report production history and for assisting in loss adjustment determinations. Finally, the 2008

Farm Bill directed RMA to enter into one or more contracts with qualified entities to carry out research and development regarding a policy to insure dedicated energy crops. A private sector study indicated that camelina was the only commercially-grown dedicated energy crop for which crop insurance was currently feasible. Coincidentally, a private sector product for camelina was submitted to the FCIC Board shortly after the study was completed. That product was approved by the FCIC Board, and coverage is now being offered in selected counties in Montana and North Dakota.

In addition to efforts to meet a very complex and diverse array of producer needs, RMA has also made changes that involve a very large number of producers, such as the recent revisions made to premium rates for corn and soybeans. The Federal Crop Insurance Act requires that RMA operate the Federal crop insurance program in an actuarially sound manner. This means that, on average, total premiums charged should cover losses plus a reasonable reserve, resulting in an expected loss ratio at or below 1.0.

RMA contracted for a comprehensive review of its premium rating methodology that was completed in the spring of 2010. Although that review determined that the rating methodology is generally consistent with accepted actuarial methodologies and practices, it recommended that RMA evaluate its use of historical loss data in establishing premium rates and consider incorporating long-term weather data. A subsequent study recommended placing greater weight on loss data from more recent years when determining premium rates (as opposed to the current approach that places equal weight across all years). For crops/areas like corn and soybeans in the Corn Belt which have experienced few losses in recent years, this generally results in lower premium rates.

RMA has generally accepted the recommendations from the study and has taken action to phase in the changes starting in crop year 2012 for corn and soybeans. We anticipate that the remaining analytical work will be completed in time to be implemented for the 2013 crop year for wheat, cotton, rice, and grain sorghum. Premium rate changes will continue to be implemented for other crops as they come due for their periodic rate reviews, which typically occur every 3 to 5 years. Premium rates for a crop and/or area will not increase more than 20 percent in any given year, per premium rate increase limits in the Federal Crop Insurance Act.

Streamlining and IT Efforts across RMA and FSA

RMA and FSA continue to work towards greater coordination on information sharing and streamlining programs, reducing both internal duplication and the burden on farmers. As an example, the 2002 Farm Bill required the Secretary to develop a Comprehensive Information Management System (CIMS) to be used by FSA and RMA in the administration of their respective programs. CIMS was made available for use in September 2007. Today, it provides access for over 12,000 users from RMA, FSA, and crop insurance companies to a single source of program information regarding producers, crop acreage, and production.

The next stage of information sharing is now underway with the Acreage Crop Reporting Streamlining Initiative (ACRSI), an effort involving not only RMA and FSA, but also the Natural Resources Conservation Service (NRCS) and the National Agricultural Statistics Service (NASS). The goal of ACRSI is to establish common data standards and a reporting framework,

facilitating ‘one-stop’ reporting by producers of production information and enabling greater USDA sharing of information. Together with CIMS, ACRSI will greatly improve the integrity and accuracy of data collected and reported to USDA, and will allow RMA and FSA to efficiently identify discrepancies, misreporting and potential fraud, waste and abuse. Both for farmers and USDA, data management and reporting burdens will be greatly reduced. ACRSI has already demonstrated results. Before the ACRSI initiative, FSA had 17 acreage reporting dates for 273 crops and RMA had 54 acreage reporting dates for 122 crops. With ACRSI, there are now 15 acreage reporting dates common to both RMA and FSA programs. There are a few exceptions for which it was not possible to establish a common date, though such exceptions are few.

In time, CIMS and ACRSI will allow producers to provide “common information” one time at their first visit to USDA or their crop insurance agent and have that information shared seamlessly across USDA. However, this will not eliminate the need for each agency to collect data independently. While there is considerable overlap in the customer base between FSA and RMA, they are not identical. In addition, there is a significant amount of data that RMA needs for the operation of its programs that is not collected by FSA –and vice versa –it will still be necessary for each agency to collect the data that is unique to its programs. .

Technology is also key to making our services more convenient and efficient over time. As you know, FSA is proposing to close 131 field offices across the country in response to declining budgets and a declining workforce. Just 10 years ago, FSA had roughly 17,000 people working for FSA. Today, that number is closer to 12,000. To help FSA continue to provide effective delivery of our programs despite declining budgets and a shrinking workforce, we will continue to invest in and make progress with the Modernize and Innovate the Delivery of Agricultural Systems (MIDAS) project. The initial design for MIDAS is completed and the program is now in the build phase, where the system is configured, the applications are developed and the IT infrastructure is put in place. Assuming MIDAS is funded at $107.5 million in FY 2012, by 2013 the first version of MIDAS will begin to operate covering farm records, customer data, and acreage reporting. This first version of MIDAS will reduce the time for county office employees and farmers to conduct business, and provides a scalable platform to continue to deliver additional programs in a timely manner. Our goal is to build and deliver a solution that is adaptable to the needs of customers today and in the future.

President’s FY 2013 Budget

Lastly, I’d like to talk about several components of the President’s FY 2013 Budget which, as you know, proposes to reduce the deficit by $32 billion over ten years by eliminating direct farm payments, reauthorizing disaster assistance, decreasing crop insurance subsidies, and better targeting conservation funding to high priority areas. Farmers and ranchers know the importance of a healthy economy, which raises incomes and increases demand for their products.

The budget would maintain a key component of the safety net for producers in times of volatility and natural disaster by extending the 2008 Farm Bill disaster assistance programs (or implementing similar programs) through the 2017 crop year, or to the end of the next farm bill, at a cost of about $8.4 billion over 10 years.

Given budgetary pressures, the President's FY 2013 Budget proposes eliminating direct payments. Direct payments are made regardless of economic need. Having strong disaster assistance programs along with a growing increase in producer participation in crop revenue insurance programs provides income assurance to bankers should disasters strike during the growing season and targets assistance to when and where it is most needed. Eliminating direct payments would create savings of about $31.1 billion over 10 years.

Finally, I'd like to talk about the President's proposed changes to the crop insurance program. The proposal focuses on four elements:

- First, premium rates for catastrophic coverage are adjusted to reflect the historical loss experience for this coverage. Since first being authorized in 1994, losses for catastrophic coverage have consistently been well below the 1.0 target loss ratio. This suggests that the catastrophic premium rate could be significantly reduced without adversely impacting the soundness of the crop insurance program. This re-rating will not impact or affect farmers in any way, as they are not charged a premium for this level of coverage, but it will provide savings of about $255 million over 10 years.
- Second, the proposal would reduce the administrative and operating expense (A&O) payment that is provided to the companies for the delivery of the crop insurance program. This proposal further reduces the existing cap on A&O and would save about $2.9 billion over 10 years.
- Third, the proposal would reduce the expected return to companies from the sale of crop insurance. In the new Standard Reinsurance Agreement, the target rate of return on retained premium to the companies for the risk they retain is about 14 percent. Of course, in any given year underwriting gains can be larger or smaller than the target because of crop losses or price movements. The agreement is structured to provide about a 14 percent return on retained premium to the companies over time. Based on independent studies, we believe that roughly a 12 percent return on retained premium is sufficient to adequately support the industry. This would save $1.2 billion over 10 years.
- Fourth, the proposal would reduce by 2 percentage points the amount of premium subsidy provided on behalf of producers who are currently purchasing policies where the subsidy to them is more than 50 percent of the premium. This will not affect any producer whose subsidy is at 50 percent or below. This would save about $3.3 billion over 10 years.

We recognize these are difficult choices and we take very seriously any proposed changes or cuts to the farm safety net. As this Committee and this Congress work to craft a Farm Bill proposal and decide how best to allocate our limited resources, we welcome further debate and discussion with you on the best path forward.

Conclusion

As we look to the future, the volatile market and weather conditions of recent years underscore the importance of providing an adequate safety net to producers. Thank you very much for allowing me to appear before you today. We look forward to working with you and providing any technical assistance that Congress needs in developing the next farm bill. I will be happy to answer any questions.