

**STATEMENT BEFORE THE SUBCOMMITTEE ON GENERAL FARM
COMMODITIES AND RISK MANAGEMENT,
U.S. HOUSE COMMITTEE ON AGRICULTURE**

**Hearing to review federal farm policy
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Thank you, Mr. Chairman, for the opportunity to participate in today's hearing.

I want to focus on the question of whether current Federal safety net programs are making the best use of tax dollars or whether an alternative approach could better meet the needs of both farmers and taxpayers. I take as a given that Congress wants to continue to provide support to agriculture, and in my limited time, I will not address the larger question of whether significant farm bill support should be expanded beyond the so-called program crops that include feed and food grains, oilseeds, cotton, and peanuts.

In designing any type of program, one needs to first determine the program's objective. I assume that the Federal farm safety net should be designed to give farmers a good chance to pay off their expenses and survive years of significant financial stress. Financial stress occurs when farm receipts are low or costs are high. Variations in revenue have far greater impact on a farmer's bottom line than do variations in cost, so aid should be targeted at revenue rather than costs. Low farm revenue can be caused by either poor yields or low prices, or a combination of both.

Federal safety net programs are administered by two USDA agencies: the Farm Service Agency and the Risk Management Agency. As is generally the case, the programs of these agencies are not tightly coordinated. A case can be made, though, that the two agencies' programs do complement each other. FSA administers programs that make payments when prices are low and RMA's crop insurance programs make payments primarily when yields are low. Because both low prices and low yields are covered, farmers should have an adequate revenue safety net. But a closer examination of current programs reveals some glaring weaknesses.

Let's begin with a look at the marketing loan program, which provides producers with either a marketing loan gain or a loan deficiency payment when the local spot price falls below the loan rate. Consider what happens in a low-price year, such as we had in 2004 for corn. A corn farmer who had the misfortune of not producing a corn crop received no benefit from the marketing loan program. Farmers who harvested bumper crops received large loan deficiency payments because they had so many bushels to claim under LDP. Thus, the marketing loan program under-compensates farmers with low yields and over-compensates farmers with high yields.

Over-compensation occurs for two reasons. First, because no payment offset is made for those farmers who have bumper crops to sell, net farm income actually increases in low-price, high-production years. Furthermore, in these high-production years, the price at which marketing loan gains and LDPs are calculated is generally much lower than the price at which the crop is actually sold. That is, on average, the program over-protects most farmers in low-price years.

Some believe crop insurance prevents under-compensation by making up for low yields. In 2006, farmers bought federal crop insurance on 194 million acres of program crops. The average coverage level on these insured acres is approximately 70%. This means that, on average, farmers will not receive any insurance coverage until they have experienced a 30% loss. And in most regions, the actual deductible is much greater than 30% because the yield used to calculate the insurance guarantee is much lower than what farmers expect to harvest. Furthermore, nearly 25% of program crop acreage is not insured. Taken together, these statistics means that less than 60% of the expected market value of program crops is insured. The lack of insurance on at least 40% of market value is perhaps why the call for ad hoc disaster assistance programs is so persistent.

To summarize, taken together, FSA's price protection programs and RMA's crop insurance programs do provide valuable tools for farmers to manage their risks. But the provided coverage often misses the mark and costs are high. Marketing loan programs pay, on average, more than is needed to compensate farmers for price declines. And the net cost to taxpayers of the crop insurance program from 2001 to 2005 has been \$15.1 billion. Fully 42% of this \$15.1 billion flowed to crop insurance companies through underwriting gains (\$2.5 billion) and operating expenses (\$3.8 billion). To put it another way, it has cost taxpayers \$1.71 for each dollar of producer benefit from the crop insurance program.

It may seem odd that I am focusing on the crop insurance program at a Farm Bill hearing. But a better farm safety net could be created if the best ideas from crop insurance were combined with the most effective approaches from Title I of the current farm bill.

The first step is to recognize that under- and over-compensation can be minimized by targeting farm programs directly at low revenue rather than at low prices. It makes sense that a target revenue program would be more efficient at protecting revenue than either a target price program or a combination of a target price and crop insurance.

Next we would need to decide if the target revenue program should target actual farm revenue or a more aggregate measure of revenue, such as revenue at the county or state level. The advantage of targeting farm revenue is that payments would reflect actual farm losses. But there are many disadvantages. Farm-level losses are costly to monitor and verify. The program would be open to the same fraud and abuse as the current crop insurance program. Also, for a given coverage level, farm-level programs cost much more than programs at a more aggregate level of coverage, such as the county, the crop reporting district, or the state.

If the target revenue program made payments when county revenue is low, then the program would cost less than to administer than current farm programs and the program would not create incentives to defraud and abuse the system. Furthermore, we already have a working example of a target revenue program at the county level in our crop insurance program. Group Risk Income Protection pays indemnities when county revenue falls below a guaranteed level. The only significant difference between an effective Farm Bill target revenue program and GRIP is that Congress might choose to use a fixed target price or a rolling average of market prices to set the target revenue guarantee rather than futures market prices that can greatly fluctuate from year to year. Acreage insured under GRIP has climbed to 11.7 million in 2006 from only 1.2 million acres in 2003 as farmers have come to realize what a good product it is.

To reiterate, there are several benefits of a target revenue program at the county level:

1. It would target the economic variable, revenue, that farmers use to pay their bills;
2. It would provide protection against the two most important sources of risk that producers of program crops face: low prices and low yields caused by widespread weather events.
3. By covering systemic price and yield risk, a target revenue program would enable private insurance companies to insure the remaining farm-level risk without federal involvement.
4. It would do away with any rationale for Federal disaster aid for producers of program crops because county-level losses would automatically trigger payments.
5. Coverage is scalable so Congress could decide on the appropriate coverage level given competing needs for scarce Farm Bill funds.

We have studied what a target revenue program would provide in terms of protection and cost relative to existing programs, and there is no doubt that better protection can be obtained from a target revenue program at lower cost. But perhaps it is more instructive to look at the cost of a target revenue program relative to taxpayers' current contribution to GRIP. We estimate that per-acre costs for GRIP in the form of premium subsidy, expected underwriting gains, and administrative and operating expenses would cover the cost of an acre enrolled in a target revenue program at a coverage level of 97%. That is, Congress could give crop farmers 97% coverage at the county level for the same per-acre taxpayer cost of GRIP today.