RAFI-USA

Rural Advancement Foundation International - USA

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Written Statement of
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To the
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Subcommittee on Commodities and Risk Management Hearing
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Chairman Etheridge and Ranking Member Moran, members of the subcommittee, thank you very much for this opportunity to address the subcommittee about crop insurance, and specifically about how crop insurance affects the ability of farmers to adjust to recent shifts in our agricultural economy.

My name is Scott Marlow, and I am the director of Farm Sustainability for the Rural Advancement Foundation International – USA. RAFI-USA is a non-profit organization based in Pittsboro, NC that addresses issues of equity, sustainability and diversity in agriculture and rural communities. I am also here on behalf of the thousands of farmers in North Carolina and across the country that we have worked with over the last 15 years to help access new markets, seek equity in production contracts, get reward in the marketplace for the environmental stewardship that they do or help find ways to keep going in the face of disasters of weather or price. My testimony is based on the specifics of our experience in North Carolina, but we are also addressing these issues with farmers from across the southeastern United States, and the rest of the country.

While crop insurance has a long history of providing effective risk management for the traditional crops of North Carolina agriculture, recent changes in our farm economy mean that the Risk Management Agency faces a series of challenges in providing effective risk management for a significant percentage of North Carolina farm income, and we expect these challenges to increase in the years to come.

Between Hurricane Floyd in 1999 and Hurricane Katrina in 2005, the percentage of eligible North Carolina acreage participating in crop insurance increased from 56% to almost 78%, but the percentage of North Carolina farm receipts covered by crop insurance, based on North Carolina Department of Agriculture and Consumer Services and Risk Management Agency data, fell from 19% in 1999 to around 13% in 2005, and the percentage of farm income eligible for crop insurance fell from approximately 38% to 28%. [1] It is not that crop insurance changed, but that crop insurance did not change to keep up with changes in North Carolina's farm economy.

The segments of the farm economy with extensive crop insurance, commodities such as tobacco, cotton and corn, while vitally important to many farmers in our state, have dropped in their percentage of North Carolina farm receipts. The fastest growing segments of North Carolina's farm economy - livestock produced under production contracts, specialty crops like greenhouse, nursery and Christmas trees, and emerging value-added markets such as organic and specialty livestock - are all underserved, if served at all, by current crop insurance programs. We are moving rapidly from crops with extensive risk management and disaster programs to enterprises with ineffective or no risk management. Today I would like to focus on three issues associated with this transition.

Issue 1. Lack of risk management for operations with production contracts.

The greatest percentage of North Carolina farm income, almost 60%, now comes from broilers, turkeys and hogs. The structure of these livestock industries has significant effect on the outlook for risk management programs. According to the 2002 Census of Agriculture, 69% of hogs and essentially 100% of broilers raised in our state were raised under production contracts where, according to USDA definitions, the producer never owns the animal.[2] We are also seeing anecdotal evidence of production contracts being adopted in specialty crops and other non-livestock areas.

In the past, the Risk Management Agency has acknowledged the gap in risk management for livestock producers[3], and in hearings before this subcommittee last week, Dr. Keith Collins outlined 2 current pilot programs for livestock. It is important to note, however, that animal ownership is essential for eligibility in both of these programs and neither will provide risk management for livestock produced under production contracts. Livestock producers are also increasingly concerned about the risks of disease outbreaks, quarantine or preventative depopulation by either state or federal officials as they are currently not insurable causes of loss.

There is precedence for benefits to producers of livestock under production contracts in *ad hoc* disaster programs. The 2000 Supplemental Appropriations Act passed on Nov. 29, 1999 targeted $ 10 million for contract growers[4] under the Livestock Indemnity Program. Following Hurricane Katrina and the other Gulf Coast hurricanes of 2005, Congress made some assistance available to contract growers in the form of Livestock Indemnity Payments and Emergency Conservation Program cost share assistance for cleaning up debris from poultry barns and/or costs to reconstruct or repair barns if there were uninsured losses.[5] However, *ad ho*c programs that Congress may or may not pass after a specific disaster are no substitute for risk management that contract growers may incorporate into their farm business planning on an ongoing basis.

Recommendation:

Crop insurance programs must be developed that insure against the risks associated with production contracts and the unique ownership structure that they bring, either by developing crop insurance programs specific to production contract income, or by including production contracts in currently existing programs that insure income rather than products. Livestock programs must also include the peril of quarantine, depopulation by federal or state government and bio-terrorism as insurable causes of loss.

Issue 2: Lack of risk management for value-added products critical to mid-scale agriculture.

Nationally, we are losing the mid-scale farms that have made up the backbone of our agricultural economy and land stewardship. The most rapid loss is among those farms that are too large to access the growing direct market economy, but too small to compete in the undifferentiated commodities market – the agriculture of the middle.[6] Last year, North Carolina led the nation in the loss of farms.[7]

But we are also seeing a rapid rise in demand for high-quality, specially-raised products like organic produce, heirloom vegetables and specialty meats, what we call "food with a taste, a place and a face," driven by consumer demand and an increase in spending on away-from-home food.[8] According to Rick Schnieders, the C.E.O. of the Sysco Corporation, the defining aspect of retail food is price, whereas the defining aspect of restaurants and food service is differentiation. As consumers shift more of their food dollar to food consumed outside the home, there will be greater demand for the type of differentiation of products that only mid-scale farmers can provide.[9]

These emerging markets for natural, organic and specialty foods have grown beyond the ability for the small farmers who pioneered them to fill, and require the capacity and the management capability of the mid-scale farmers that we are currently losing. The greatest hope for mid-scale farmers is the transition to production of high-value, specialized crops and livestock brought to niche markets in ways that bring a greater percentage of the food dollar back to the farm, and our greatest challenge is assisting mid-scale farmers in connecting to these markets before they go away.[10]

Crop insurance plays an important role in encouraging or discouraging that transition, both in providing risk management, and because crop insurance determines access to credit and access to additional disaster program benefits. In a 2004 survey of tobacco farmers, RAFI-USA found that 67% identified access to capital as a key barrier to diversifying their farm. In a yearlong study with agricultural lenders in North Carolina, we found that lenders based the expected value of crops for both collateral and budgets on assured income as determined by either conventional commodities markets or crop insurance. Because the added value of specially marketed crops like organic is uninsured, it is frequently not included in either collateral valuation or anticipated income. The farmers of these crops are therefore more likely to be required to put personal property up as collateral for operating loans in addition to the crop itself, and are less likely to have a farm plan that shows a positive cash flow. While lenders do not recognize the higher value of specialty crops, they do recognize the higher expense of producing them.[11]

Recent crop disaster payments have been based on benefits received under crop insurance or the Non-Insured Disaster Assistance Program (NAP). While this choice makes sense in that it rewards participation in risk management programs, it leaves those farmers who are not eligible for effective crop insurance programs without assistance. If proposed crop disaster payments are combined with crop insurance, conventional farmers will receive compensation for nearly 100% of their damage, whereas producers of value-added, niche and specialty crops without effective crop insurance will receive nothing.

In our experience, there is currently no crop insurance that provides effective risk management for the value that farmers add through either specialized production or marketing. The lack of risk management for value-added products, and the reduction in access to credit and other disaster programs that accompanies it creates a financial disincentive for farmers to make the transition, and increases the risk and vulnerability of those that do.

The challenge for crop insurance is that the emerging markets and differentiated products do not come with the uniformity and automatic data collection that provides the underpinning of conventional commodity crop insurance. The very aspects of these markets that make them vibrant and exciting and profitable – the ability to respond quickly to a wide variety of specific niches of quality and production – are the same aspects that make it extremely difficult to program for them. The traditional product development approach of developing a crop-specific risk profile and then releasing a crop-specific insurance product is unable to address the diversity of emerging products, enterprises and markets.

In recent years, RMA has been piloting the Adjusted Gross Revenue (AGR) and Adjusted Gross Revenue – Lite (AGR-Lite) crop insurance programs. AGR and AGR-Lite provide income insurance based on the five-year average of gross farm revenue as established on Schedule F of the farmer's taxes, including value added through specialty markets and addressing the complexity of many small and mid-size farms. Since 2005, North Carolina has been fortunate enough to be one of the pilot states for AGR-Lite.

While AGR and AGR-Lite are simple in concept, they have proven to be extremely complicated in implementation. Because of the complexity of both application and claims adjustment, crop insurance agents are reluctant to promote it and farmers are reluctant to trust it. Specifics in the requirements of the program have made it difficult to determine eligibility of income and coverage of losses, and some farmers have been surprised to discover the limitations of their coverage only when their claims were adjusted. In short, this program is not working.

These difficulties have been borne out in declining enrollment numbers, both in North Carolina and nationally, despite significant outreach efforts. From a high of 970 policies nationally in 2003, enrollment dropped steadily to 551 in 2007. As the only programs that address value-added markets, it is critical that we get AGR and AGR-Lite right.

Recommendation:

The AGR/AGR-Lite programs should be extended, but reformed to be more accessible and affordable, and then expanded to be available nationally. Reform should include specific steps to address shortcomings in the program, but should emphasize streamlining the application and claims adjustment processes, and shifting the program structure to reward diversification and innovative marketing.[12]

Issue 3: Inequity for organic producers.

Of the rapidly growing high-value markets, organic is the best recognized and provides the clearest example for crop insurance. Many current crop insurance programs are available for organic crops, but the structure of these programs penalizes organic farmers and creates a financial disincentive for seeking organic certification. When an organic producer signs up for crop insurance, they pay an extra 5% surcharge that is assessed to offset perceived additional risk associated with organic production, although this perceived risk has not been quantified by research.

When farmers receive crop insurance and other disaster program benefits, these benefits do not recognize the added value of organic, and payments are calculated based on the conventional price. For an organic farmer who receives a price for organic product that is double the conventional price, 75% crop insurance coverage based on the conventional price actually covers 37% of the farmer's income. Organic farmers in essence pay more for less coverage. This double inequity needs to come to an end.

When an organic farmer's lawsuit to receive assistance under the Crop Disaster Program based upon the market price for organically grown adzuki beans was successful[13], USDA promptly changed the program regulations to allow assistance only at the conventional price. The courts have upheld the new regulation[14] so action by Congress is the only way to ensure that organic farmers receive assistance based on their market price, just as conventional farmers receive assistance based on the market price for their goods.

Recommendation:

Organic producers should have access to insurance programs that meet their needs without putting them at a competitive disadvantage to conventional producers. The 2007 Farm Bill should eliminate the current five percent surcharge on premiums for organic producers and establish a deadline for providing payments that reflect organic market prices to organic producers.[15]

In closing, access to effective crop insurance programs is essential for farmer's transition to the emerging markets that are the key to the health and vibrancy of mid-scale agriculture. Thank you for the opportunity to testify today, and I welcome any questions from the committee.

Notes:
1. Percentage of coverage was determined using percentage of eligible acreage participating from the RMA State Crop Insurance Profile (http://www.rma.usda.gov/pubs/state-profiles.html) and the percentage of farm receipts by commodity from North Carolina Department of Agriculture and Consumer Services Agricultural Statistics Service (http://www.ncagr.com/stats/cashrcpt/cshcomyr.htm). Percentage of greenhouse / nursery participation was estimated using the percentage of total value of greenhouse / nursery products that were represented by crop insurance liability.

2. "Under a production contract, the farmer provides services to the contractor, who usually owns the commodity under production. For example, contractors in poultry production usually provide chicks to the farmer along with feed and veterinary/transportation services. The farmer then raises the chicks to maturity, whereupon the contractor transfers them to processing plants. Contractors often provide detailed production guidelines, and farmers retain far less control over production decisions. The farmer's payment resembles a fee paid for the specific services provided, instead of a payment based on the market value of the product."

Nigel Key and James MacDonald, "Agricultural Contracting; Trading Autonomy for Risk Reduction." USDA Economic Research Service. Amber Waves Volume 4 Issue 1. February 2006. Pg 28.

3. Eldon Gould, Review of the Federal Crop Insurance System. Hearings before the Subcommittee on General Farm Commodities and Risk Management of the House Committee on Agriculture, March 15, 2006

4. Pub. L. No. 106-113, Appendix V, Title I, Chapter 1, 113 Stat. 1501

5. Emergency Supplemental Appropriations to Address Hurricanes in the Gulf of Mexico, Pub. L. No. 109-148, Division B, Title I. (December 20, 2005) and Emergency Agricultural Disaster Assistance Act of 2006, which was enacted into law on June 15, 2006 as Title III of the Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recover Act of 2006. The formal citation of the Act is Public Law Number 109-234)

6. For more information about the issues associated with agriculture of the middle, including current research and overview documents see the web site of the National Task Force to Renew Agriculture of the Middle at www.agofthemiddle.org.

7. North Carolina Department of Agriculture and Consumer Services Press Release, "North Carolina leads nation in loss of farms … again." 2/19/07. http://www.ncagr.com/paffairs/release/2007/2-07farmloss.htm

8. Stewart, Hayden, Noel Blisard, Sanjib Bhuyan and Rodolfo Nayga, "The Demand for Food Away From Home, Full service or fast food." United States Department of Agriculture Economic research Service Agricultural Economic Report Number 829. January, 2004

9. Schnieders, Rick, "Presentation to the Georgetown University Law School." Available at http://www.agofthemiddle.org/papers/sysco.pdf.

10. Kirschenmann, Fred, Steve Stevenson, Fred Buttel, Tom Lyson and Mike Duffy, "Why Worry About Agriculture of the Middle." White paper prepared for the National Task Force to Renew Agriculture of the Middle. Available at http://www.agofthemiddle.org/papers/whitepaper2.pdf

11. The full report on the Farmer / Lender Project is available at http://www.rafiusa.org/pubs/puboverview.html.

12. Draft AGR/AGR-Lite reform recommendations:

1) Streamline application process and adjustment process to increase farmer access to the program and encourage crop insurance agent participation, clarifying coverage and benefits.
2) Provide higher levels of coverage on AGR/AGR-Lite whole farm revenue programs. Current deductibles are too high for producers. The maximum effective coverage for AGR-Lite is 72% (80% coverage, 90% payment rate). In many cases, thin profit margins do not allow a 28% drop in revenue without severely impacting the viability of the farm operation. Consider an 85% coverage level and 100% payment rate like several of the MPCI coverages.
3) Add a "floor" to the 5-Year income history used to determine coverage levels. Low revenue can reduce the approved AGR to the point where the insurance will not provide adequate coverage. Example: maintain the 5 year Schedule F average, but allow up to 10 years if available.
4) Crop insurance payments and Noninsured Crop Disaster Assistance (NAP) are not considered allowable income in the 5-year history but are considered revenue to count for claim purposes. Adding MPCI indemnities and NAP to allowable income would provide a floor to compensate for low revenue years.
5) The animal/animal product rates need reviewed to more accurately reflect the risk. More analysis is needed to see which risk pool livestock commodities should go into versus simply putting all livestock in the highest risk pool.
6) Carryover commodities still in the production phase present some unique beginning and ending inventory challenges. The inventory rules should be reviewed to ensure the procedures provide clear directions on how to handle these commodities. In addition, clarity should be provided as to whether or not coverage is provided for these commodities including Christmas trees, shellfish, nursery, and livestock.
7) Strengthen the policy regarding establishing local market value, particularly for direct marketers. Currently, the policy indicates that if published prices are not available, then the average price offered by two commercial buyers, one nominated by the policyholder and one by the insurance company, should be used. This needs to be strengthened in two ways. First, for direct marketers it should be the best estimate of those involved in direct marketing, as commercial buyers are not involved. Second, the value for estimating the revenue for the producer's intention report for the current year should be determined at the time the intentions report is filed, otherwise the producer loses the price fluctuation protection otherwise provided by the policy. There are reports where the price is either not finalized at the time the intention report is filed or that it is adjusted at claims time. Neither is acceptable because such changes can reduce the producer's protection that was initially sold to them and adversely impacts the collateral value of the policy.
8) Definition of 'Animals' needs to be revised to ensure it is inclusive of production agriculture. The current definition is "living organisms other than plants or fungi that are produced or raised in farming operations including, but not limited to, aquaculture, bovine, equine, swine, sheep, goats, poultry, aquaculture species propagated or reared in a controlled environment, bees, and fur bearing animals, excluding animals for sport, show, or pets." For shellfish farm eligibility it may be helpful to modify the definition by adding: Shellfish (licensed commercial producers under the local approving authority in a certified growing area). This will further define the controlled environment and eliminate recreational versus commercial operations. Another definition issue involves 'fryers.' While poultry is currently listed in the definition, a fryer is not. It also needs to be clear that animals under contract are insurable.

9) Develop mechanisms to extend AGR and AGR-Lite to new and beginning farmers so they have the opportunity to utilize federal risk management programs. Strong consideration should be given to permit such producers to have protection and premium rates established based on information for similar farms that have sufficient historical information to meet the requirements of these insurance plans.

13. *Pringle v. United States of America*, 1998 U.S. Dist. LEXIS 19378 (E.D. Mich. 1998)

14. *Partlo v. Johanns*, 2006 U.S. Dist. LEXIS 43071 (D. D.C. 2006)

15. Proposed Legislative language on organic:

Crop Insurance – Premium Surcharge

Section 508(d) (7 U.S.C. 1508) of the Federal Crop Insurance Act is amended by adding a new (d) as follows:
(d) Surcharge Prohibition. – The Corporation may not require producers to pay a premium surcharge for using scientifically sound sustainable and organic farming practices and systems.

Crop Insurance – Market Prices

Section 508(c) (7 U.S.C. 1508) of the Federal Crop Insurance Act is amended by adding a new (5)(C)(v) as follows:
(v) in the case of organic commodities, shall be, no later than October 1, 2009, the expected or the actual organic market price of the agricultural commodity, as determined by the Corporation.