United States Department of Agriculture

Office of the Chief Economist
1400 Independence Avenue, SW
Washington, D.C. 20250-3810

November 9, 2007

The Honorable Dianne Feinstein
United States Senate
Hart Building Room 331
Washington, D.C.

Dear Senator Feinstein:

Thank you for your letter of November 6, 2007, in which you requested a prompt analysis of the Farm, Ranch, Equity, Stewardship, and Health Act of 2007 (S. 2228). You requested an assessment of the effects on the majority of states and on Federal agricultural spending received by California farmers in comparison with the farm bill passed by the Senate Committee on Agriculture, Nutrition and Forestry (S. 2242) (Committee bill). You also requested an assessment of the costs and benefits for all California farmers purchasing Adjusted Gross Revenue insurance at the 80 percent coverage level.

Both S. 2228 and the Committee bill contain many complex provisions affecting agricultural producers that differ from current programs. Both bills are comprehensive and provide benefits to producers directly and indirectly through numerous titles. Based on communications with your staff, we will focus this response on the commodity price and income support and Adjusted Gross Revenue (AGR) crop insurance provisions under the two bills. As an example of the complexity, the Committee bill continues direct and countercyclical payments, the marketing assistance loan program, and offers an optional revenue countercyclical program called Average Crop Revenue (ACR). Federal payments to states will partly depend on the extent to which producers opt into this new ACR program. The Committee bill is to be joined with the Senate Finance Committee bill that includes a standing disaster assistance program. Alternatively, S. 2228 terminates the marketing assistance loan program and phases out direct and countercyclical payments. These programs are replaced by free whole-farm AGR insurance and risk management accounts that are funded by the Department of Agriculture (USDA) and voluntarily by the producer.

Because these programs are so complex and new, USDA has been unable to conduct a state-by-state analysis of S. 2228 or the Committee bill, so we cannot provide you with the impacts on the majority of states under either bill.

We can provide some information on California relative to the two approaches to farm program support. Under current programs, we project that producers of program crops in California (wheat, rice, upland cotton, corn, barley, sorghum, oats and oilseeds) would receive about $200 million in direct payments annually during the 2008-2012 crop years. They would also receive a projected $95 million in countercyclical payments and $45 million in marketing assistance loan benefits annually. Thus, California program crop producers would receive a projected total of $340 million annually during crop years 2008-2012. Under the Committee bill, these payments would differ resulting from some changes in marketing assistance loan rates, target prices and the level of participation in the ACR program. However, we believe the difference in farm program benefits between current law and the Committee bill for California would not be significant.

Under current law, California has 3.7 million acres insured under Federal crop insurance with a total liability of $3.7 billion. The total value of the premiums for crop insurance in California is $185 million, and the value of the premium subsidies paid by the government is $132 million. Of the $3.7 billion, $53 million, or a little over 1 percent is accounted for by the AGR plan of insurance. (The attached Appendix to this letter provides background information on the historical operation of the AGR plan of insurance in California.) Under the Committee bill, crop insurance program participation incentives are similar to current law, although the Senate Finance Committee bill's standing disaster provision requires crop insurance for eligibility, and that requirement may increase California crop insurance participation somewhat above current levels. The standing disaster program is estimated to cost on average about $1 billion annually during fiscal years 2008-2012. We project that California producers would receive about $50 million annually in benefits under the disaster provisions of the Senate Finance Committee bill.

Under S. 2228, the primary vehicles for producer income support would be free whole farm AGR insurance for all commodities and farm risk management accounts. Under current AGR provisions, there are diversification requirements and a $6.5 million liability limit per policy, thus not all of California's $31 billion in agricultural commodity production value is likely to be insured under AGR policies. However, to illustrate the potential benefit of free insurance, we assume all of California agriculture is covered by 80 percent AGR policies. Assuming the premium rate on Adjusted Gross Revenue policies is 5 percent of insured liability (the actual rate for existing California policies), the total premium for AGR insurance on 80 percent of the total value of California production would be about $1.25 billion per year. With an actuarially sound premium, this $1.25 billion would also about equal the expected annual indemnities paid to producers over the long term, although in any one year indemnities would depend on actual losses. Because this insurance would be provided free, this $1.25 billion is the gross value of the free insurance to producers. Under current law, California producers now receive $132 million in premium subsidies, thus the net value of the free AGR insurance to California producers under S. 2228 is estimated to be about $1.12 billion per year.

In addition to the subsidy value of the free insurance, the producers would receive contributions into their risk management accounts as well as phased-down direct payments. USDA would contribute direct payments in excess of $10,000 into the producer's risk management account. The total value of direct payments and risk management account contributions is projected at $45 million annually during crop years 2008-2012.

S. 2228 is a reform-oriented bill that would end current price and income support programs and replace them with free insurance and risk management accounts. Traditional program crop producers would see their current program benefits replaced by free AGR insurance and reduced direct payments. Some would also have government contributions to their risk management accounts. For some program crop producers with limited production risks, the 80 percent AGR insurance would not offset the loss of traditional farm program benefits. Non-program crop producers, such as specialty crop producers, would see increased benefits from free crop insurance and the availability to establish risk management accounts.

I hope this letter provides useful information. You or your staff may contact me at 202-720-4164 or keith.collins@usda.gov if you need more information.

Sincerely,

Keith Collins

Keith Collins
Chief Economist

Attachment

Appendix: Background on Adjusted Gross Revenue Insurance in California

Adjusted Gross Revenue (AGR) insurance has been available in California since 2003 and is offered in eight counties in California: Fresno, Kern, Riverside, San Diego, San Joaquin, San Luis Obispo, Tulare, and Ventura. The average crop value per AGR policy since 2003 has been about $600,000. An 80 percent guarantee for all policies would result in an insured value (liability) of $480,000 per policy.

The average premium rate for AGR policies in California with 80 percent coverage is about 5 percent of liability, or $24,000 per policy. However, the government pays for 48 percent of the premium for policies with 80 percent coverage. This results in an average annual farmer-paid premium of around $12,500 per policy.

Over the long run, the amount of premium charged is expected to cover indemnities plus a reasonable reserve. This results in an expected long run average annual indemnity of around $21,000 per policy, or around $105,000 over a given five-year period. However, actual indemnities paid over the five-year life of the next farm bill may be significantly above or below the expected long-run average depending on what, if any, loss events occur.

The AGR policy has a liability limit of $6.5 million as established by the Federal Crop Insurance Corporation Board of Directors due to the nature of it being a pilot program. This may prevent some California farmers from being eligible for AGR coverage. A contracted evaluation was done on the pilot program highlighting some issues and problems needing further attention, especially relating to certain complexities in administering the program for producers who purchase existing individual crop polices and AGR, and for handling changing inventories and market price fluctuations in future crop years. Thus, the program remains in pilot status today.

Some summary statistics of the AGR plan of insurance for California are presented in the following table.

Summary Statistics for the Adjusted Gross Revenue Plan of Insurance in California

	2003	2004	2005	2006	2007
Number of Policies	199	195	139	136	116
Total Crop Value	$115,847,070	$109,509,854	$83,068,853	$92,747,984	$72,301,020
Total Insured Value (Liability)	$84,840,033	$79,097,256	$60,805,086	$68,371,865	$52,614,063
Total Premium	$3,817,561	$3,611,667	$2,706,100	$3,248,323	$2,849,504
Total Producer-Paid Premium	$1,743,975	$1,620,199	$1,219,468	$1,472,662	$1,280,799
Indemnity Paid	$4,156,602	$2,581,311	$1,222,404	$5,282,640	
Loss Ratio	1.09	0.71	0.45	1.63	