SEP 20 1994

For Thurs. Farm Bill meeting

September 20, 1994

MEMORANDUM FOR: CAROL RASCO
ALICE RIVLIN
BOB RUBIN

FROM: BILL GALSTON
BO CUTTER
T.J. GLAUTHIER

SUBJECT: 1995 FARM BILL REAUTHORIZATION

Introduction

The reauthorization of the farm bill, which occurs every five years, will be one of the most challenging legislative processes facing the administration during the 104th Congress. As you know, this is a comprehensive bill that addresses not only agricultural issues, but also economic development, conservation, nutrition, international aid, and many other matters. The administration will be expected to submit its recommendations early next year.

USDA is now in what we hope are the final stages of collecting its thoughts. Over the summer, an interagency group led by DPC/NEC/OMB troika and involving other agencies as well inventoried recent information and policy options. During the fall, we must reach closure on administration recommendations. This will require "microdecisions" on dozens of specific issues. More importantly, it will require a "macrodecision" on one key question: **How much political capital is the administration willing to expend on the farm bill during the 104th Congress?**

We strongly believe that the fall policy review cannot proceed to a useful conclusion until an authoritative answer to this question is developed. To move toward such an answer, we have focused on three broad strategic options, which we now sketch for your review.

Strategic Options

Option 1: Incremental change. Option 1 consists of incremental changes in commodity, export promotion, disaster relief, conservation, inspection services, credit, rural development, and food assistance and nutrition programs. Specifically, Option 1 would leave intact the decades-old structure of commodity programs (see the first column of the attached matrix).

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Option 1 represents in effect a decision to put a decision to put farm bill issues on autopilot in order to focus our attention in other area. It would require limited administration resources and effort to enact and minimal political capital to enact. While no member of the troika favors this option, it may well be supported by key congressional committees and in some quarters of USDA.

Option 2: Moderate change. Option 2 proposes significant reform in areas such as food inspection, conservation, and rural development, but at most incremental changes in commodity programs. In the areas this option singles out, a fair degree of consensus has crystallized about the need for basic reform, if not on the exact nature of that reform. If we were willing to invest a moderate amount of political capital in Option 2, we could probably make progress in the reauthorization without requiring significant personal involvement on the party of the President, Vice President, or chief of staff and without generating possible tradeoffs with other key elements of the administration's 1995 agenda.

This option is favored by Cutter and Glauthier.

Option 3: Aggressive change. Option 3 would combine the significant programmatic reforms of Option 2 with an equally bold effort to reform the commodity programs. Such an effort might involve shifting these programs away from traditional supply revenue fluctuations and improved stewardship of natural resources. It might also include endorsing the NPR proposal for consolidation of food safety and inspection services.

This option could free up resources for significant new investments in areas such as rural development and agricultural research. It would certainly encounter major opposition from supporters of established programs. And it would require a major investment of political capital, including the willingness to resist aggressive lobbying by numerous friends of the administration.

This option is favored by Galston.

Next steps

A portion of the meeting this Thursday will be devoted to a discussion of these three strategic options. In addition, we should discuss the framework for an inclusive policy process that brings USDA and other concerned departments and agencies together in a structured working relationship with all relevant parties in the EOP.

The 1995 Farm Bill: Issues, Policies, & Opportunities

Issue & Budget Dimensions (Total FY95–99 BA: $312.2B)	Current Policy	Positive Reforms (Illustrative)	Bold Change (Illustrative)	Degree of Difficulty of Bold Change
1. Commodity Programs (FY95–99: $50.2B) (All mandatory)	Deficiency payments, nonrecourse loans, quotas, & direct purchases	Reduce "base acres", preserve marketing loans, phase out quotas and direct purchases, means–test or cap benefits.	Move to a comprehensive "revenue assurance" scheme that more directly and simply provides income support	9 on a scale of 1 to 10. Decreases if significant entitlement reductions are required in FY96 budget.
2. Export Promotion (FY95–99: $4.9B) ($4.3B Mandatory)	Loan guarantees; EEP grants to offset foreign subsidies; MPP	Substantial reforms driven by GATT UR	Accelerate such changes unilaterally	DD: 10 of 10; there is already substantial congressional resistance to current UR efforts
3. Crop Insurance & Disaster Relief (FY95–99: $8.3B) ($6.8B Mandatory)	Federally–funded, voluntary insurance with variable coverage; annual disaster relief bills	Administration has proposed reforms to reduce adverse selection; program would remain actuarialy unsound.	Combine these programs into the "revenue assurance" scheme	DD: 5 of 10. If part of revenue assurance, more difficult; if reforms not enacted this year, less difficult.
4. Conservation Programs (FY95–99: $13.4B) ($7.7B Mandatory)	Requirements on commodity program participants; federal purchase of wetlands; contracts not to farm	Continue and refine these programs; a "stewardship support payments" pilot?	Comprehensive, consistent approach to "green support," reconciling commodity and conservation programs	DD: 4 of 10. Rationalizing programs not as difficult as expanding mandates

Issues, Policies, & Opportunities (cont'd)

Issue & Budget Dimensions	**Current Policy**	**Positive Reforms (Illustrative)**	**Bold Change (Illustrative)**	**Degree of Difficulty of Bold Change**
5. Inspection Services (FY95–99: $5.3B) (All discretionary)	Multiple regulators close to industry; complementary jurisdiction to FDA	Improve accountability & techniques, e.g., through use of microbial testing	Transfer authority to FDA to ensure consistency of techniques, standards, & quality	DD: 6 of 10. Vested interests and strong lobbies will likely resist change.
6. Agricultural Credit (FY95–99: $1.3B) (All discretionary)	2 GSE's, a weak secondary market, and substantial subsidies	Improve targeting through program design, establish guarantee tranches, and greater reliance on markets	Substantial overhaul relying on credit markets and correcting specified market failures	DD: 4 of 10. Perceived inequities favor change; earlier reforms targetted at socially disadvantaged farmers.
7. Rural Development (FY95–99: $4.8B) (All discretionary)	Multiple programs focused on home construction and infrastructure	Special efforts regarding information infrastructure and economic development	Renovate programs based on competition, leveraging, strategy–driven plans	DD: 2 of 10. The least political resistance––if some new monies are available
8. Food & Nutrition (FY95–99: $216.8B) ($197.8B Mandatory)	Multiple programs providing food assistance to low–income persons	Reduce duplication, improve customer service by EBT	Welfare reform; gradual cash–out	DD: 5 of 10; 9 of 10 if involves a real reduction in benefits.
9. PL 480 (FY95–99: $7.2B) (All discretionary)	(I) Market development, (II) development & emergency programs, (III) economic development.	Merge two development efforts; leave emergency program intact. Eliminate tonnage floor.	Eliminate (I) and (III).	DD: 7 of 10; recent 50% reduction in these programs could favor bold change.

September 21, 1994

MEMORANDUM FOR CAROL RASCO
DPC PROGRAM STAFF

THRU: BILL GALSTON

FROM: BRIAN BURKE
MARION BERRY

SUBJECT: 1990 FARM BILL OVERVIEW

The purpose of this memorandum is to provide a brief description of the Food, Agriculture, Conservation, and Trade Act of 1990 ("1990 Farm Bill"). Attached to the memorandum are several white papers which discuss key provisions in the 1995 Farm Bill reauthorization. The white papers are summaries of materials compiled by OMB and used to prepare for the series of 1995 Farm Bill reauthorization seminars held during the last month. Updates and additional materials will be provided to you as the reauthorization discussions progress.

BACKGROUND

The importance of farming relative to the rest of the U.S. economy has declined for over a century. Growth in domestic food demand has not kept pace with farm productivity gains, and crop yield now far exceeds the needs of the American population. Without sustained increases in export demand, the farming sector will shrink, and resources currently devoted to agricultural production will find alternative uses in the non-farm economy. USDA commodity price-and income-support programs, the cornerstone of US agricultural policies, may slow the sector's decline but will not reverse it.

Increasing export demand is viewed by many as the best and only way to reduce subsidies to farmers without further accelerating reductions in farm incomes and the size of the farm sector. Even if the sector's size and importance were to stabilize, technological change will persist in altering the distribution of income within farming.

KEY ISSUES IN REAUTHORIZATION DISCUSSIONS

Macroeconomic policy, environmental concerns, and technological change are the three most important issues affecting US agricultural practices, policy, and reform. Agriculture is sensitive to changes in macroeconomic conditions because of its capital intensity. Farming is a highly capitalized industry and is sensitive to changes ~~is~~ in monetary policy. In the 1980's agricultural exports declined as exchange rates rose. As an example of environmental concerns, the extent and severity of water quality problems related to agricultural practices will be better understood in the next few years, bringing to the foreground the question of who pays for proposed solutions to these problems. At present, farm programs rely on cost-sharing measures to encourage better farm conservation practices, while environmental groups generally apply the "polluter pays" principle in restricting chemical use in fertilizers and pesticides. In addition, biotechnology promises a boost in farm productivity, but will also foster continuing changes in farm structure.

Policy options for reform range from (1) making revisions to the existing programs, (2) adding alternative programs to the existing structure, or (3) replacing the current regime with new programs that target the Administration's policy goals: economic security, fairness, market orientation, environmental protection, rural development, and budget deficit reduction.

SUMMARY OF MAJOR PROVISIONS

The 1990 Farm Bill is the most recent in a long series of measures enacted since the 1930's to assist farmers, primarily by supporting prices and incomes for specified commodities -- currently wheat, corn and other feed grains, cotton, rice, soybean and other oilseeds, milk, sugar, honey, peanuts, wool, mohair and tobacco. Except for tobacco, which the 1990 farm bill did not address, these commodities are the subject of the first 11 titles of the farm bill.

The 1990 Farm Bill includes 14 additional titles. Title XV extended and overhauled the US food aid and agriculture trade (including export subsidy) programs. Title XVII reauthorized and amended the food stamp and other U.S. Department of Agriculture (USDA) nutrition programs. Titles XIV and XXIV amended existing environmental and resource conservation programs and created new ones. Title XVI reauthorized and redirected priorities for agricultural research and education. Title XVIII altered farm lending process. Title XIX addressed farm and food marketing programs. Title XXIII provided new authority to promote development in rural areas.

The attached papers discuss, individually, the key Farm Bill titles.

ATTACHMENTS:

TITLES I–XI: COMMODITY PROGRAMS

OVERVIEW

The commodity programs constitute the basic mechanisms by which the federal government supports the price of select farm products and subsidizes farmers' incomes. This is accomplished by manipulating supply and demand of agricultural commodities. The programs involve large expenditures from the Treasury. Direct government outlays to the farm sector totaled approximately $80 billion over the last five years. The commodity programs influence strongly the geography and socioeconomic structure of American agriculture. The income support programs, for example, impact farmers' decisions to grow certain crops.

Commodity programs are managed by the Commodity Credit Corporation ("CCC"), a federally owned and operated corporation within the USDA. The CCC functions as the financial institution through which all money transactions are handled. To finance its activities, CCC is authorized to borrow up to a total of $30 billion at a time from a revolving fund in the Treasury. In the CCC Fund, cash outlays for loans and commodity purchases are offset by receipts from loan repayments, interest payments and sales of commodity inventories. Outcomes for income supports have no offsets. The "net realized loss" on CCC operations is reimbursed each year by mandatory appropriations, thus restoring CCC borrowing authority to the full $30 billion.

The CCC offers price support to all eligible producers of 21 commodities (including wheat, corn and other feed grains, cotton, rice, soybean and other oilseeds, milk, sugar, honey, peanuts, wool, mohair and tobacco). Approximately 60 percent of the land planted to crops in the United States is used to produce a handful of heavily subsidized commodities such as corn, wheat, cotton and rice.

The purpose of price support programs is to keep farm prices, received by participating producers, from falling below specific minimum levels. CCC stabilizes commodity prices and supports farm income by manipulating the supply and demand of agricultural commodities, by providing subsidies for the production, export finance, and the direct export of these commodities. The programs are carried out by providing loans and purchase agreements to farmers so that they can store their crops during periods of low prices. Producers receive non–recourse loans and forfeit their commodities to CCC if the market price falls below the support price ("loan rate").

The largest portion of CCC outlays are for direct income–support payments ("deficiency payments") to producers. Available for major commodities (wheat, corn, cotton, and rice), the deficiency payment is based on the difference between the price level established by law (target price) and either the higher of the market price during a period specified by law or the price support (loan) rate. The total payment is generally equal to the payment rate multiplied by the eligible acreage planted for harvest, and then multiplied by the program payment yield rate established for the particular farm. Such terms as "triple base", "acreage reduction program", and "production base" refer to the ways in which deficiency payments are determined.

In addition, CCC administers programs that support the domestic prices of certain commodities (dairy, tobacco, peanuts, sugar, honey, wool and mohair) by purchases on the open market, production quotas, restrictions on imports, or some combination of these devices.

The level of CCC outlays is primarily a function of the prevailing market prices for agricultural commodities. There is a 30 percent chance of an unexpected, significant drop in prices in any year. Some operating rules for CCC programs are set by law, such as the "target prices", while others like loan repayment rates, are left largely to Administration choices. Spending at USDA discretion, not required by law, is rising. The rise in the component of spending that is at the Administration's discretion tends to increase the budget exposure. Administrative action can reduce or expand the budget's exposure to price swings. For example, a ten cent increase in a commodity loan rate can increase CCC outlays by hundreds of millions of dollars, with normal price volatility.

REAUTHORIZATION ISSUES

The existing income– and price– support programs are strongly defended by most farm interests and congressional advocates. Last year, the Administration drastically reduced its initial $5 billion CCC reform proposals in the face of Congressional opposition. However, the 1993 OBRA reduced spending on CCC programs by about $2 billion, as estimated by CBO, and subsequent Congressional sunsetting of CCC's wool program and reductions to CCC's honey program reflect eroding support. Most farm groups believe budget pressures will mean some reduction in future subsidies authorized by the 1995 farm bill.

The options for reform are many and varied, and a proper discussion of policy choices should begin with review of the social and economic trends here and abroad that are likely to determine the fate of the agriculture sector. The rationale for regulatory reform stems from 1) the need for federal deficit reduction, 2) the pursuit of fairness in public policy, 3) the desire for increased market efficiency and economic security, 4) rural development, and last but not least, 5) environmental protection.

TITLE XIV: CONSERVATION RESERVE PROGRAM

OVERVIEW

Under the Conservation Reserve Program ("CRP"), producers can bid to enroll highly erodible land[1] into the reserve, removing it from production for 10 years. In return, farmers receive rental payments. After the 10–year period, they can bring their lands back into production. CRP was authorized in the 1985 Farm Bill to enroll a total of 40 million acres (one million of which became the Wetlands Reserve Program ("WRP") in the 1990 Farm Bill), but the CRP target was reduced to 38 million acres in the 1993 OBRA. CRP's authorization to sign up new acres terminates at the end of 1995. The FY 1995 President's Budget proposes maintaining the current acreage total of 36.4 million acres, and forgoing the final sign–up in FY 1995.

Before 1990, USDA made the acreage target the prime consideration for enrollment. From 1985–1990, agricultural production supply management was a primary goal of the program, to reduce surplus crops. The least expensive eligible acres were enrolled; this acreage met a minimum threshold of being "highly erodible". In 1990, the program began to use a ranking formula, the Environmental Benefits Index ("EBI"), to enroll the acres with the greatest environmental and conservation benefits per Federal dollar spent. The EBI used seven different measures to determine the potential contribution to conservation and environmental goals from each parcel, including surface and ground water improvement, preservation of soil productivity, encouragement of tree planting, and assistance to farmers most affected by conservation compliance.

COST EFFECTIVENESS

The cost–effectiveness of the CRP program has been questioned because the acres are not permanently retired and much of the Federal investment in these acres are lost as the rental contracts expire. This effect is especially pronounced because the 10–year contract totals are often equal to or greater than what the cost would have been for purchasing or permanently retiring the land outright. It is estimated that overall CRP contracts overpaid from $7–17/acre, such that the FY 1995 rental payments should have been closer to $1.35 billion, instead of $1.8 billion. Only in FY 1990 was a cap put on enrolling CRP acres whose cost exceeds the rental value of surrounding acres.

FUTURE OF CRP

In the context of the 1995 farm bill deliberations, a new CRP program could continue the reforms of 1990 by targeting land according to environmental and conservation benefits,

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[1] Land that meets specific conditions primarily relating to its land/soil classification and current or potential rate of erosion.

while perhaps broadening the EBI criteria to include wildlife preservation and endangered species habitat, or floodway expansion. Given the high level of interest for easements[2] WRP landholders have shown, permanent easements for CRP acres could be considered as well.

Options for current CRP lands include: enrollment in a post–1995 CRP program, CRP contract extensions or easement purchases under the Secretary's existing discretionary authority; tree planting; and hay grazing of CRP acres during the life of the contract in return for lower rental payments and a 10–year loss of crop acreage base for deficiency payment purposes. The House Environment, Credit, and Rural Development Subcommittee held a public hearing on August 2, 1994 to review the budget and policy consequences of extending the CRP (testimony is attached).

Current estimates of the existing CRP acres indicate that between 53–63 percent will return to crop production upon expiration of the contracts. The Secretary of Agriculture has the authority to extend CRP contracts expiring between 1995–2000 or to place any existing CRP contracts into permanent easement. The environmental benefits per acre of CRP vary. **By ranking the acres of the CRP with the EBI factors relative to the costs of extending contracts, a program as small as 5 million acres could capture a large portion of the environmental benefit.** Enrolling a smaller portion of highly erodible farm land will have a greater environmental benefit than including a larger tract of less erosion prone land.

SODBUSTER

Under the "sodbuster" provisions, farmers who cultivate highly erodible land -- not cultivated between 1981 and 1985 -- are ineligible for most major farm program benefits. These include price supports and related payments, farm storage facility loans, crop insurance, disaster payments, any loans from Farmers Home Administration that will contribute to erosion of highly erodible lands, storage payments, and conservation reserve program payments. These benefits are lost for all the land the farmer cultivates, not just for the highly erodible lands. A producer is not subject to these provisions if he cultivates his highly erodible land using an approved conservation plan[3].

Under the conservation compliance, the sodbuster provisions apply to all highly erodible land, even if it was cultivated between 1981 and 1985, starting in 1990. If a

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[2]Conservation easement is a partial interest in land usually held by a government entity which limits the uses of the property, or prohibits certain actions, in order to achieve certain conservation objectives. When using the farm of a reserved interest deed, the grantee acquires all rights, titles, and interest in a property, except those rights that might run with the land expressly reserved by a grantor.

[3]A combination of land uses and practices to protect and improve soil productivity and to prevent soil deteriorating. A conservation plan must be approved by the local conservation district for acreage offered in the Conservation Reserve Program. The plan sets forth the conservation measures and maintenance that the owner or operator will carry out during the term of the contract.

producer has obtained an approved conservation plan, s/he will have until 1995 to fully implement that plan, or lose his benefits.

SWAMPBUSTER

Under the "Swampbuster" provisions, a farmer who drains and then cultivates a wetlands loses the same farm program benefits as a sodbuster.[4] Under a number of conditions, wetlands are exempt, including wetlands previously converted or artificially created, wetlands created by irrigation or water delivery systems, wetlands where agricultural production is possible under natural conditions or where production has a minimal effect, and areas where the producer follows an approved wetlands conservation plan. More than 5 million acres of wetlands are estimated to have a high or medium potential for conversion to cropland.

WETLANDS RESERVE PROGRAM ("WRP")

Agriculture is by far the nation's leading cause of wetland loss.[5] The WRP was created in the 1990 Farm Bill and pays producers to permanently retire wetland acres from production. The goal of the program was to restore one million acres of cropland to their original wetland functions and values by 1995. To date 125,000 acres have been enrolled. The President's FY 1995 Budget proposed to enroll 300,000 acres in FY 1995, but House and Senate Appropriations bills would only permit 100,000 acres in 30 states to be enrolled.

Up to an additional 100,000 acres will be enrolled in FY 1994 in areas affected by the Midwest Flood, as authorized by the Flood and Earthquake supplemental bills last year. WRP shares a method similar to the CRP for selecting acreage, with a formula ranking lands according to environmental benefits per Federal dollar. WRP also has a payment cap on the fair market value of the land.

REFORM ISSUES

Groundwater and Water Quality Issues. Groundwater pollution has rapidly emerged as a major issue as more instances of contamination have been identified. A basic question is whether the known instances of contamination represent the "tip of the iceberg" or are isolated instances; there is far less information on this topic than on traditional conservation concerns, such as soil erosion.

Water Supply Issues. There are two main water supply issues. One issue revolves around a double cost to the Federal treasury when water supplied at subsidized rates from

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[4]Wetlands have many environmental benefits including water filtration, spawning and water foul habitat, and flood reservoirs.

[5]See footnote #5 above.

Federal water projects is used to grow crops in surplus that the Federal Government is then forced to acquire under current commodity programs. The second issue involves the agricultural use of water in the Southwest. Critics believe that producers having access to this water receive an unfair subsidy, one that gives them an unfair advantage over producers in other areas. Other critics believe that as development occurs in the Southwest, markets should be available to sell water to the highest bidder.

Sustainable Agriculture Sustainable agriculture is increasingly viewed as a potential solution to many current environmental and resource problems that are byproducts of production agriculture. Farmers are seeking ways to control input costs and protect profit margins while maintaining productivity, and environmentalists are looking for ways to make agriculture more benign. Sustainable agriculture includes the collage of activities that range from totally organic systems to targeted and efficient application of agricultural chemicals. This approach contrasts with conventional agriculture, which uses a full range of tillage practices and larger quantities of chemical inputs.

Opposition to sustainable agricultural efforts has come primarily from producers who see no need to change from conventional agriculture, and manufacturers and distributors of products that are used most heavily in support of conventional agriculture (fertilizers, pesticides, etc.). In addition, many legislators have called for more flexible commodity program rules to support sustainable agriculture goals. Greater flexibility might allow producers to use approved crop rotations without being penalized financially, as they are under current commodity program provisions.

Major sustainable agriculture provisions were included in the research title of the 1990 Farm Bill, Title XVI. In addition, under the conservation title, the Secretary is to develop a voluntary integrated farm management program that assists farmers in adopting plans that reduce barriers to resource stewardship.

TITLE XXII: CROP INSURANCE AND DISASTER ASSISTANCE

OVERVIEW

Farming is a risky business -- susceptible to natural disasters that, in addition to fluctuating market prices, can have a profound and unanticipated effect on crop production on farmers' finances. Federal crop insurance is a subsidized insurance program which provides farmers with a means for risk management and financial stability against crop production loss. The insurance is available for 50 different crops, varying by county. Participation in the program is often required for a farmer to qualify for Federal emergency loans. The Federal Crop Insurance Corporation ("FCIC") insures individual crop yields against losses from unavoidable production risks. Losses due to negligence or poor farming practices are excluded.

With the exception of a brief period in the 1940's, the federal government has offered some form of crop insurance since the 1930's. In 1980, Congress redesigned crop insurance to make it the preeminent form of agricultural disaster assistance. The Federal Crop Insurance Act ("FCIA") of 1980 established goals, including (1) erase government-funded disaster payments by increasing crop insurance participation, (2) provide crop insurance more efficiently by taking advantage of private sector expertise, (3) decrease insurance costs for farmers by providing federal subsidies, and (4) operate within the budget. A 1992 GAO report stated that the redesigned crop insurance program has been unable to meet all of these goals.

HOW CROP INSURANCE WORKS

In the federal crop insurance program, insured farmers who do not achieve specified production levels are paid indemnities out of the total premiums paid by all insured farmers or by other sources of funds available to the insurer. The farmer achieves greater revenue stability in exchange for the premium payment, even though the inherent risk of low crop yield remains. FCIC offers county crop programs for specific crops in individual counties. Farmers may participate in the insurance program if they plant an eligible crop where FCIC offers a county crop program.

Participating farmers can elect yield-guarantee coverage of 50, 65 or 75 percent of their 10-year actual production history ("APH") yield, if available. For example, a farmer with a 10-year average yield of 100 bushels per acre who selects a 50-percent level of coverage would be eligible for an indemnity payment if production fell below 50 bushels per acre. To translate a yield loss into a dollar loss, participants also select a commodity price level -- from 30 to 100 percent of the crop's expected market price, which is then multiplied by the actual number of bushels that fall below the coverage level. Premiums depend on the insured crop, location, farming practices (such as irrigated or non-irrigated), and yield level, as well as coverage and price levels selected.

DISASTER ASSISTANCE VERSES CROP INSURANCE

Crop insurance and crop disaster payments have historically served the same function: to indemnify farmers for crop production losses. The crop disaster payment structure is similar to crop insurance, but it is free to producers. Unlike crop insurance, disaster assistance is not a permanent reliable source of federal assistance to farmers; however, **disaster assistance promotes farming in unproductive areas because it is costless.** The incentives to make disaster payments available to farmer constituents have proven to be nearly irresistible, especially in light of the problems in the crop insurance program.

The expansion of the crop insurance program in 1980 was intended to replace direct disaster payments. Participation in the crop insurance program was encouraged through premium subsidies provided by the Government of up to 30 percent. In spite of these high farmer subsidies, participation in the insurance program did not go above 40 percent of eligible acres. Low participation, in turn, encouraged Federally funded crop disaster relief. **Every crop year since 1987, farmers have been bailed out with a crop disaster relief bill.** For this reason, coupled with existing, but seldom used mandatory authority for USDA to make disaster payments, the FY 1995 Budget for the first time included disaster spending in the mandatory baseline, at a $1 billion per year through FY 1999 (the 10-year average expenditure). **The high costs of the crop insurance program combined with low participation increasingly raised questions regarding the crop insurance's mission and effectiveness.**

BUDGETARY CONSIDERATIONS

In FY 1994, crop insurance costs comprise $290 million in discretionary spending for FCIC administrative expenses and private company expense reimbursements, and $1.186 billion in mandatory spending for premium subsidies and excess loss payments. The Federal Government subsidizes (at an average rate of 25 percent) crop insurance premiums. It also reimburses private insurance companies roughly 33 cents for every premium dollar sold for administrative expenses. Combined, for every farmer-paid premium dollar, the FCIC outlays roughly $2.56.

ACTUARIAL PROBLEMS

The federal crop insurance program has not achieved actuarial soundness because (1) crop production risks are not normally independent, (2) FCIC does not have sufficient information to calculate individual risk, and (3) FCIC does not have sufficient information to determine the cause of losses. An actuarially sound insurance program should break even over time. For every dollar in premium, one dollar in indemnity would arise. Since 1980, crop insurance has suffered from low farmer participation and high actuarial losses. **From 1981-1990, total indemnities exceeded total premiums by $2.5 billion.** The average loss ratio for the program is 1.4; that is, for every dollar in premium one dollar and forty cents is paid in indemnities. Losses tend to be highly concentrated, roughly 6 percent of all producers collected 28 percent of all indemnities.

<u>**Losses are not independent.**</u> Many weather-related hazards can reduce crop yields over large areas of the nation, thereby increasing the chance that a substantial number of policies will require indemnification during the same year and will affect actuarial soundness. This widespread impact reduces the effectiveness of insurance because risk pooling, one important way insurers can reduce the costs of bearing risk, is less likely to be successful if there is a large degree of correlation across the risks facing the insured individuals. In theory, the program's expanded geographic coverage provides more opportunities for diversification because weather patterns vary across the nation and yields of specific crops vary by region. In practice, however, these opportunities may be limited. For example, although the expanded crop insurance program offers coverage for 50 crops, the top 3 crops -- corn, soybeans, and wheat -- account for roughly half of total premium revenue. Furthermore, these crops experience similar movements in loss ratios.

<u>**Adverse selection and moral hazard.**</u> The crop insurance program also suffers from adverse selection and moral hazard. Adverse selection arises as producers are better informed about the distribution of their yields and can better assess the actuarial fairness of their premium. Producers who expected indemnities to exceed premiums are more likely to purchase coverage than farmers whose probability of collection is small. Adverse selection also occurs through risk shifting by the reinsured companies. Reinsured individuals can elect to shift risk to FCIC by choosing between various reinsured risk pools for their business. Better business is placed in risk pools with less reinsurance and higher profit sharing. More risky business is placed in a pool where FCIC covers more losses and profit sharing is lower. Moral hazard arises because the actual yield is subject to influence by the producer's actions throughout the growing season. A recent study[6] concluded that moral hazard is an important problem that contributes to a large part of the persistent losses (as much as 20 percent or more in major crops) incurred by FCIC.

<u>**Risk indicators are not always accurate.**</u> Because crop insurance guarantee levels, premiums, and indemnities are based on the individual farmer's yield, an accurate estimate of potential loss depends on individual farm information. FCIC's estimate of a farmer's expected yield is the only farm-level information FCIC uses to determine an individual farmer's riskiness. In 1987, FCIC began using APH data, a 10 year average of yields at the individual farm level, to estimate a farmer's average yield. However, FCIC does not use APH data to determine a farmer's yield variability as an additional measure of risk. This creates several problems. One, farmers do not always have completed data for 10 years and therefore the data may not accurately reflect the farmer's actual yield and therefore may skew the average yield on which FCIC assesses risk. Second, the APH data may not capture increases in crop yields; overtime crop yields tend to increase because production methods improve. Therefore,

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[6]Richard E. Just and Linda Calvin, "Moral Hazard in U.S. Crop Insurance: An Empirical Investigation," (work in progress), University of Maryland, Apr. 1992.

the APH yields may be lower than the farmer's true expected yield. Third, there can be difficulties in verifying a producer's production claims.

Researchers indicate that for the program to continue to be based on individual yields and yet be more actuarially sound, FCIC must do more. For example, collecting additional farm–level information would combat adverse selection and moral hazard. However, collecting more information would probably increase costs, and it is unclear how much adverse selection and moral hazard problems can be lessened through such efforts.

REFORMS AND RECENT LEGISLATION

In recent years, Congress has enacted legislation to reduce crop insurance's cost and increase participation rates. The 1990 Farm Bill shifted more risk expense to private companies, and the 1993 OBRA mandated actuarial changes to improve insurance losses.

The Administration's Proposal. To build on the actuarial reforms enacted in 1993 OBRA, the Administration's FY 1995 Budget proposed comprehensive reform of the crop insurance program, starting in crop year 1995. The key components of the reform are: 1) repeal of discretionary and mandatory ad hoc disaster authority for most commodities, including emergency designations for crop disaster bills, 2) free catastrophic crop insurance coverage for losses exceeding 50 percent of normal yield,[7] 3) mandatory participation for all CCC farm program participants and Farmers Home Administration borrowers, and 4) a standing disaster program for crops not covered by crop insurance, with payments triggered by area–wide loss levels. Attached is a summary of the key elements of the Federal Crop Insurance Reform Act of 1994.

The Administration's comprehensive crop insurance reform legislation may be considered by the House Age Committee this week. The legislation is likely to be subject to extensive debate due to an expected amendment from Congressman Tim Penny that substantially cuts incentives to farmers and expense reimbursement to agents. The Senate bill is being held up in the Agriculture Committee by Senator Helms.

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[7]A $50 administrative fee would be charged per crop.

PESTICIDES AND FERTILIZERS

BACKGROUND

Pesticides and fertilizer nutrients threaten clean water nationwide. Agriculture represents the leading cause of poison runoff pollution of surface waters, and conventional farming practices have been linked conclusively to pesticide and nitrate contamination of ground water. To the extent to which the USDA has addressed pesticide issues, the emphasis has been primarily research and intergovernmental coordination.

CURRENT REGULATIONS

The use of pesticides and fertilizers is not specifically addressed in the Farm Bill. Instead, their use is covered under many Acts, including the Federal Insecticide, Fungicide, and Rodenticide Act ("FIFRA"), and the Federal Food, Drug, and Cosmetics Act ("FFDCA"), the Clean Water Act and the Watershed and Flood Prevention Act.

REFORM ISSUES

Currently, there are three pesticide reform bills pending in Congress: the Administration's; Representatives Biley, Lehman and Rowland; and Senator Kennedy's. Congress has not yet acted on these. Because of the lack of action on the three pesticide reform bills and the desire of the farm community to have a greater say in the outcome of pesticide legislation, pesticide reform legislation may be included as part of the Farm Bill debate.

Farmers are concerned about the pesticide legislation currently pending in the Congress. For example, farmers want to ensure that the pesticides they need are available. The agriculture community has sought to ensure that the economic benefits, as well as the health and environmental risks of pesticides, continue to be considered in the pesticide regulatory process. This issue is most pressing for fruit and vegetable farmers and other "minor crop" farmers. Because of the high cost of registering and reregistering pesticides, many chemical companies have dropped registrations for pesticides for which there is a small market. Often these "minor use" pesticides are the only alternatives the farmers have for fighting a certain pest or disease. In addition, the agricultural community is concerned about growing pressure from various sources for more wholesale reform of pesticide use.

In response to the agricultural community's concerns, as well as concerns expressed by environmental groups, chemical manufacturers and consumers, the Administration sent a pesticide safety bill to Congress reforming the existing pesticide registration legislation. Among other things, the Administration's bill addresses public health issues raised by the

FFDCA's "Delaney Clause"[8] and the National Academy of Science's ("NAS") report on pesticides.[9] The Administration's bill addresses these issues by establishing a negligible risk standard for setting tolerances for both raw and processed foods, and by requiring that the tolerance setting process take into account the potential impact on sensitive subpopulations.

[8]The Delaney Clause prohibits residues of cancer causing pesticides in processed foods.

[9]The NAS report raised questions about the current pesticide regulatory system's ability to adequately protect sensitive subpopulations, such as children.

MARKETING AND INSPECTION SERVICES

BACKGROUND

The purpose of the marketing and inspection services is to ensure the safety of food, the cost efficient marketing of agricultural products, and an open market for such products. Marketing programs are used to develop commodity standards, provide grading services, circulate information and provide technical assistance to the wholesale agricultural market. The Food Safety and Inspection Service ("FSIS") is the USDA agency that has the primary responsibility for assuring the safety and wholesomeness of livestock, poultry, and their products intended for human consumption.[10]

GAO ASSESSMENT

In 1993, the GAO reviewed the USDA management programs and **found that the meat and poultry inspection system was not effective or efficient use of resources to protect the public from microbial contamination and recommended that Congress revise the meat and poultry acts to provide FSIS with the flexibility and discretion to target its inspection resources to the most serious food safety risks.**

GAO found that the federal inspection system is neither efficient nor effective in protecting the public from the most serious health risks caused by microbial contamination. Inspection processes are hampered by inflexible legal requirements and relies on outdated and labor intensive inspection methods, consuming approximately two–thirds of their staff budget annually. The inspection requirement is labor intensive and costly because FSIS inspectors must visit thousands of plants daily regardless of the potential health risk involved.

To redirect FSIS' inspections towards firms and food processes that pose the greatest risks, Congress passed the Products Process Improvement Act of 1986, which amended the requirements on inspection frequency of meat processing plants. The agency is responsible for overseeing the meat and poultry industry and ensuring the safety of meat and poultry.

Additionally, these inspections can not detect microbial contaminants[11] because FSIS does not routinely test for the microbial contamination nor does it require industry to do so. The plants that have initiated microbial testing programs have used the test to identify problem areas and made numerous changes that were designed to improve the safety of their

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[10]The National Performance Review recommends developing a nation uniform inspection system to ensure a safe food supply and combining responsibility for food safety and inspection in one agency (preferably FDA).

[11]Microbial contamination, such as E. coli and salmonella, are widely recognized as today's most serious health risks associated with meat and poultry.

products. However, FSIS, has not supported this effort by designing generic programs and/or disseminating information gained from individual testing programs. As a result, the investment required of plants interested in improving their processes by implementing microbial testing programs could be significant and thereby discourage such testing, particularly in small plants.

A Hazard Analysis and Critical Control Point system ("HACCP") is generally considered to be the best approach currently available for ensuring safe foods because it focuses on preventing contamination rather than detecting contamination once it has occurred. To strengthen regulation of the industry and help ensure safer meat and poultry, Secretary Espy announced in May 1993 that each meat and poultry plant would be required to develop and implement a HACCP system. However, the HACCP requirements do not specifically require microbial testing to monitor plants' HACCP systems. Without specifying testing requirements and criteria, FSIS cannot ensure that each plant's HACCP system will effectively monitor microbial contamination.

GAO RECOMMENDATIONS

To improve the safety of meat and poultry, GAO recommends that the FSIS Administrator develop a mandatory HACCP system that includes specific requirements for microbial testing and guidelines for determining when microbial test results warrant action by the plant. As part of this effort, the Administrator should assist meat and poultry plants in the development of their microbial testing programs by, among other things, disseminating information on the programs already in operation.

Small-town America caught in farm crunch

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Chi Trib 10/20

The Midwest farm landscape is changing rapidly. Second of two parts.

A1 (104)

By Jon Margolis
TRIBUNE STAFF WRITER

File: FARM BILL '95

SHARON SPRINGS, Kan.—Just before graduation, School Supt. Fred Staker opened the local paper to the page with the pictures of the high school graduates, all 14 of them.

"This one will go to college," Staker said. "I don't think he'll come back." He pointed to another picture. "She's going to school out of town. I doubt that she'll be back. This young man is going into law enforcement, probably someplace else."

Staker paused for a moment. "He may stay," he said, pointing to another graduate. "Here's someone whose family owns a substantial farm. But I would guess that over half of them would not come back."

Not many people who leave Sharon Springs come back, at least not to stay, which is one reason the population of Wallace County has shrunk to 1,821 at last count, down from 2,045 in 1980 and 2,215 in 1970.

And possibly still falling. Though the big rush of farm foreclosures stopped a decade or so ago and the 330 farms in the county are considered "pretty strong" by County Agent Glen Bronkaw, corporate farming, now legal for dairy and hogs in Kansas, threatens some mid-sized operators.

In addition, the declining power of the farm bloc and the realities of the federal budget are likely to mean cutbacks in farm subsidies, putting even more of a squeeze on smaller farm operations. And in Wallace County, farming is just about the only economic opportunity.

"There is nothing but agriculture," said Brenda Beringer, the county's former economic development coordinator. "And agriculture is no different than any other industry in that the technology has improved so that more can be done with fewer bodies or hours."

AP photo

Corporate farming and reduced federal subsidies are putting the squeeze on smaller farm operations and, in turn, many rural communities are in jeopardy.

Agriculture is different in that it is directly subsidized by the federal government, and while Wallace County's proud residents may not like to hear it, the fact is that their towns survive now only by federal largesse.

Now, as those payments are expected to decline in next year's farm bill, the question is whether places like Sharon Springs, nearby Weskan, and hundreds of other small towns in the rural Midwest can survive at all, or whether they will be blown away by the prairie wind.

Decades ago, the decline of farming in the Northeast was visible as forests reclaimed abandoned pastures and cropland. Now on the Great Plains, the frontier is reclaiming some of the land the pioneers painfully wrung from it a century or more ago. Wallace County now has fewer than two people per square mile, the old standard that distinguished a "settled" area from a "frontier."

According to an analysis by Frank and Deborah Popper of Rutgers University, "Kansas actually has a larger 'frontier' today than it did in 1890." A century ago, they said, 25,649 square miles of Kansas had a population density of less than six people per square mile. Now it is 26,309 square miles. "The frontier is edging East," they wrote. "Once it represented the nation's future; now it recalls its past."

But in this part of the country, abandoned towns, sparse population and broken lives might be the wave of the future.

Not that the agricultural Midlands will disappear. From the Mississippi Valley where "the quality of soil and climate is far more suitable for farming than anywhere else in the country," as one expert put it, to the high, dry wheatlands of the Dakotas, farmers will grow corn, soybeans, milo and wheat and produce dairy products for as long as anyone can foresee.

But as far as small-town survival is concerned, many experts say one must consider the middle of the country as two separate regions: the eastern Midwest from Ohio through Iowa, where most of the small farm towns have already either died or survived as bedroom communities for nearby cities; and the western Great Plains, where the cities are so far apart that some small towns have survived, until now, because farmers need to shop, bank and get other services someplace.

Because there will still be a lot of agricultural production, "suppliers of chemicals and fertilizers will be OK," said Iowa State University agriculture professor Neil Harl, but not the ones that depend on numbers of people. So communities will gradually shrink.

In short, some towns will survive, and some will not, at least not unless they can find something else to serve as an economic base.

In most places, it's hard to see what else could serve. There are rural areas that are thriving, even gaining population. But Kenneth Johnson of Loyola University in Chicago, who studies rural population trends, pointed out that the only areas that grew were those with "amenities"—mountains, lakes, forests and the like.

There is precious little of that on the Plains, but some people hope Sharon Springs can attract people because it is not far from the Rocky Mountains of Colorado.

"It's only three hours from Colorado Springs," said school Supt. Staker, who has a vacation home in the Rockies. "With telecommmunications, some people can live anywhere, and here you get a fine quality of life at a low price."

From: BOB NASH

rough sell, and there are hundreds of small towns from Oklahoma to North Dakota that can't even claim proximity to the mountains.

"We would never engage in triage," said former Agriculture Secretary Bob Bergland. "But the truth is, try as hard as we can, we are not making headway in North Dakota."

Bergland said that at a symposium almost two years ago at which the word "triage" was used a great deal, though always reluctantly. Hardly anybody wants to be the person who gets up and says to the people of a town who love it: "You can't survive, so we're going to give up on you."

But, said Ralph Grossi of American Farmland Trust, triage "is happening anyway," whether or not anyone plans it, and without planning, it is likely to accelerate. Many towns survive thanks less to farm subsidies than to Social Security checks to their few remaining, elderly citizens.

According to a study by the General Accounting Office, only 6 percent of the 69 million rural Americans live on farms, and only 22 percent of the nation's 2,400 rural counties rely on agriculture as an economic base.

In the view of many economists, the problems of agriculture are not what ail the rural parts of the country. It is the failure of the non-farming sector of the rural economy that makes life difficult for so many residents of small towns in the middle of the country. "The trailer park and the manufacturing plant are more characteristic of rural people's lives and livelihood than are family farms," wrote professors William Browne, Jerry Skees, Louis Swanson, Paul Thompson and Laurian Unnevehr, authors of "Sacred Cows and Hot Potatoes," a scholarly but sprightly book about the current farm situation.

Most workers in rural areas rely on industrial and service jobs, and their wages lag far behind the pay rates in metropolitan areas.

"There has been no progress in lowering our rural poverty rate since 1960," said Rep. Richard Durbin (D-Ill.). "The working poor are more likely to live in rural areas. Jobs and non-farm industries in rural areas pay an average of $19,600 a year, 73 percent of the level in urban settings."

In fact, even most farmers rely on non-farm income. "I have two boys and they both work off the farm and both of their wives work," said Doris Harrison, who ranches and farms with her husband in Wallace County. "With everybody working, we're all right."

... you want to keep farmers on the land, boost the other kinds of income opportunities in rural areas," said Robert Paarlberg of Harvard's Center for International Affairs. "That sort of income diversification is what has kept many farmers on the land."

But if there is general agreement that rural areas need something else besides agriculture to survive, there is so far no answer to this question: What is that something else?

From slightly east of the Farm Belt, in New York, Quentin Hope has a few suggestions.

"There's a potential for small-scale, flexible manufacturing, some of it agricultural oriented," says Hope, who grew up in Garden City, Kan., and wants to return to the Great Plains to work in economic development. "There are a lot of mechanical skills in some of those small towns."

In Sharon Springs, for instance, some people would like to try to lure slaughterhouses. The local ranchers raise cattle and the farmers raise hogs. Why send them to Omaha or Garden City to be slaughtered when that work could be done in town, benefiting the local economy?

"But the powers that be don't want that," said one local man, who did not want to be identified. "They like Sharon Srpings to be clean. If you bring in that kind of facility you bring in a different odor and you bring in a different kind of people."

Some of those people would not be white or English-speaking, and the man was implying that some of his neighbors might prefer economic decay to racial diversity. Nearby Garden City has packing plants, and it has what Quentin Hope called "problems in multiculturalism."

But Barry and Jackie Walker, who moved from Phoenix back to Sharon Springs, Barry's hometown, for the country atmosphere and to run the weekly newspaper, said there are some other, more valid, reasons to be wary of growth. "I don't see prejudice," Barry Walker said. "We have minority families in the community. But I'm not sure people really want the town to grow. It's more a quality-of-life question."

The Walkers said they would welcome light industry with its "better caliber of work force," but former economic development coordinator Beringer said "it's very difficult" to attract such firms to a town such as Sharon Springs.

There are alternatives to agriculture. "Just think of Dodgeville, Wis.," Durbin said. That's where Lands' End, the telemarketing and mail order retailer, has set up shop. There are other examples, such as the Cabelos sporting goods store and catalog center in Sidney, Neb. Such firms, which do a lot of business on the telephone, are attracted to the rural Midwest because so many people speak clear, unaccented English.

But there are not enough firms like this to save all the small towns of the region. Some will wither away, raising the possibility that much of the Great Plains will consist of long stretches of abandoned villages and deserted farms.

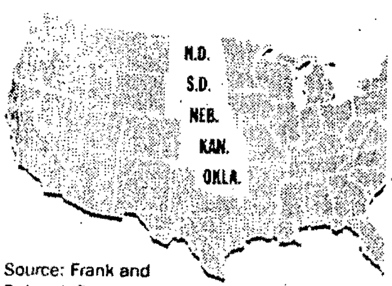
Frank and Deborah Popper suggested letting that process happen, returning some of the land to prairie and converting the resulting "Buffalo commons" into a series of ecological parks, dude ranches and other tourist attractions.

Even if the Poppers were not from New Jersey, this proposal would probably have enraged farmers and ranchers on the

3013

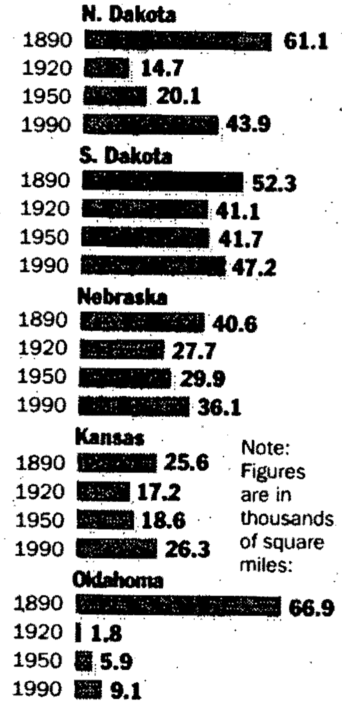
'Frontier' returning to Great Plains

The depopulation of some rural areas is shown in a study by Frank and Deborah Popper of Rutgers University. Since 1920, some Great Plains states have added 'frontiers' – counties with less than six people per square mile. Kansas had more frontierland in 1990 than it did in 1890.



Source: Frank and Deborah Popper

▶ **'Frontier' square miles**



Note: Figures are in thousands of square miles:

Chicago Tribune/Martin Fischer, Terry V

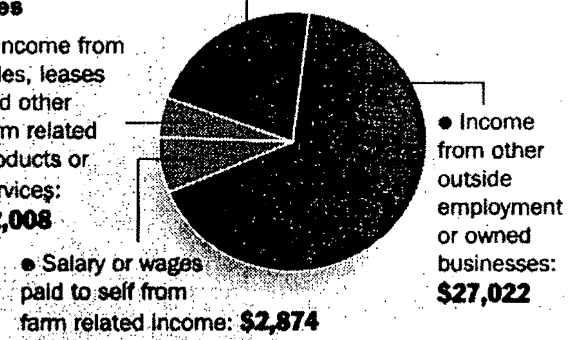
A matter of money

The average farm household earns much more money from non-farm sources than from farming.

▶ **Income sources**

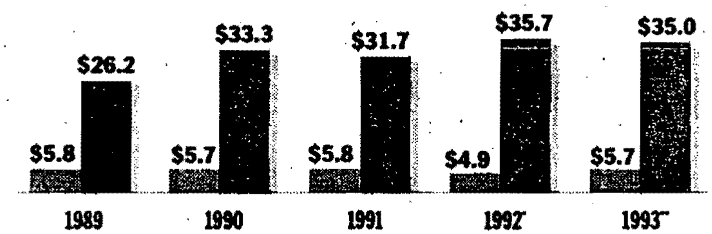
Average dollars per farm-operator household in 1992, preliminary estimates:

Total: $40,613



▶ **Farm and non-farm income**

Average in thousands of dollars per farm-operator household per calendar year.



*Preliminary figures **Forecasts Source: U.S. Department of Agriculture

Chicago Tribune/Martin Fischer, Terry Volpp

Great Plains. They are producers of basic necessities, not providers of optional services. Asking people who have raised beef or fixed farm machinery to transform themselves into tour guides, nature instructors and park rangers may be asking the impossible.

But demand for beef raisers and farm mechanics is dwindling, and as the economy continues its transformation from production of goods to provider of services and amenities, parts of the Midwest already are reverting to prairie.

Besides, if places like Sharon Springs are to thrive, their biggest asset may be not their soil, water or skilled farmers but something far less tangible.

"We have something to offer here" said Beringer. "It's being able to come into a community and actually take ownership in that community. You can become the person you really want to be. You have the opportunities, without the threats, to cultivate the gifts that may be within you."

Beringer is not naive. She knows the reputation of small towns in the middle of the country is not one of openness and acceptance.

"People may kind of go, 'Are you kidding?' at first, but I was raised out in this area. I know the openness of the people. You can become active into the community however much you want to or as little as you want to. You could say to yourself, 'Let's see, I'm a mechanic but I've wanted to do some creative writing.' We have community education facilities. We have other people you could meet with, and people will accept you."

Sharon Springs is a community because the land around it once provided opportunity to farm and ranch. Now those opportunities have dwindled, forcing the town to try to sell itself—to survive on the basis of the community those opportunities once created.

Maybe it can work here. But it can't work everywhere.