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Testimony of David Schemm
President, National Association of Wheat Growers
Before the House Agriculture Subcommittee on General Farm Commodities and Risk Management
The Next Farm Bill: Commodity Policy, Part 1
March 28, 2017

Chairman Crawford, Ranking Member Nolan, and Members of the Subcommittee, thank you for the opportunity to testify today. I'm David Schemm, the president of the National Association of Wheat Growers. I raise wheat, corn, grain sorghum, and sunflowers on my farm near Sharon Springs in western Kansas. Thank you for holding this hearing as part of a larger series of hearings each of the Subcommittees are holding to review programs ahead of the next Farm Bill reauthorization.

Wheat growers across the country have experienced a multitude of challenges the past couple of years, with unfair competition from countries like China that have support systems that distort trade, a dollar value that is relatively high making our wheat more expensive than other major wheat producing-countries, and a bigger than expected crop right here at home last year. Wheat prices have been on the decline for the past couple of years, and took a significant dive last year. Prices are at unreasonably low levels right now and are expected to remain low for the foreseeable future. Programs authorized in the Agricultural Act of 2014 (the Farm Bill), and the crop insurance program in particular, have served has key tools to enable farmers to continue farming.

As the 2014 Farm Bill programs have been implemented, there have been some hiccups along the way. We've worked through them and have sought your help in influencing implementation, and we sincerely appreciate your help and attention to our concerns along the way. Despite those hiccups, the programs have been functioning as they were supposed to: as a safety net for producers. Through my testimony, I will highlight some key examples of how these programs have functioned effectively and some areas where tweaks would be helpful.

Let me start by laying out the economic conditions in wheat country.

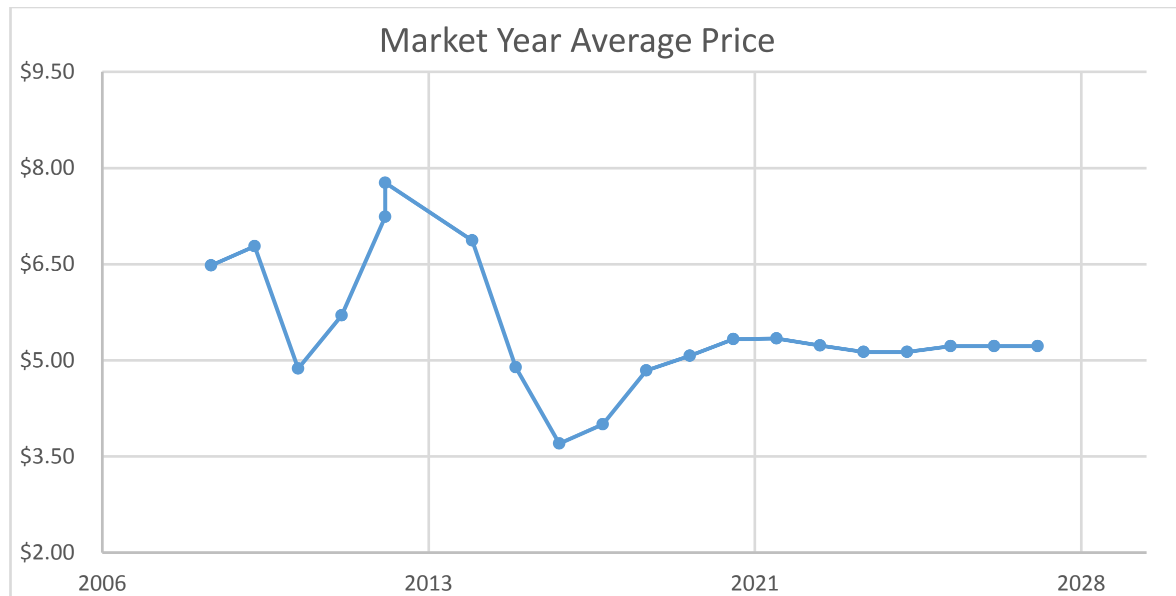
Economic Conditions in Wheat Country

The past couple of years have proven to be particularly challenging for wheat farmers across the country. Farmers of most commodities are experiencing lower than normal prices. Wheat in particular has dipped to levels we haven't experienced in a long time. Producers of Hard Red Winter (HRW) wheat in my neck of the woods became eligible for marketing assistance loans (MALs) and Loan Deficiency Payments (LDPs) for several months for the first time in several years because prices dropped below loan rates. When the last Farm Bill was written, loan rates were set at such a low level they were never expected to trigger. They have, but MALs and

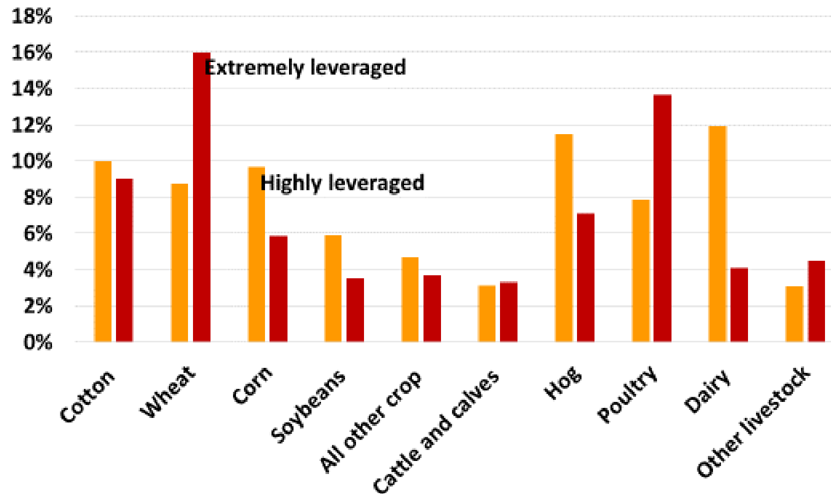
LDPs have functioned as helpful cash flow tools. Farmers have had to deal with a rapidly declining market, and months and years of sustained low prices will make each passing year more difficult to get by, particularly for young and beginning farmers who weren't able to build up reserves during the high price years. This is particularly relevant as the average age of a farmer is 58 and expected to climb over the coming years.

There have been a number of different factors that have contributed to the low prices, which I will discuss throughout my testimony. One additional contributing factor has been market competition from other large wheat-producing countries. Though this falls outside the scope of Title 1, I strongly believe that Congress needs to continue to aggressively pursue new markets. Along those lines, NAWG supports reauthorizing doubling funding for the Market Access Program (MAP) and Foreign Market Development (FMD) program as part of the next Farm Bill.

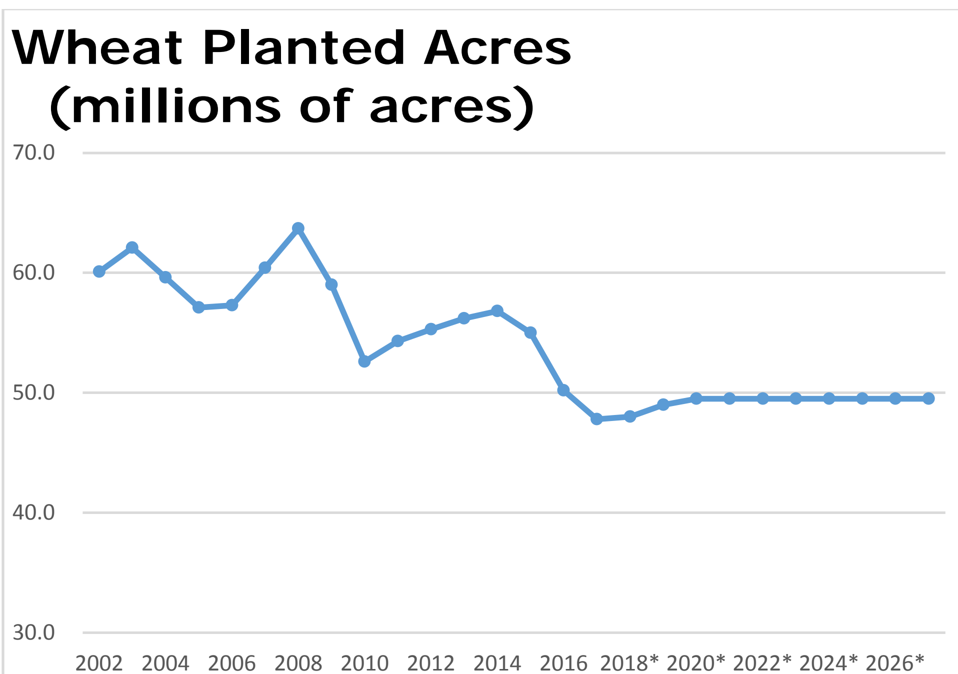
As the chart below laying out the market year average price shows, there have been some big swings over the past few years and more recently there have been significant drops in prices; the market year average price is determined by USDA and is used in setting farm program and crop insurance payments. Additionally, as I'll discuss later in my testimony, the price that farmers are actually receiving from their local elevators is often much lower than what the market year average price would show.



The data in the above chart for 2008 through 2015 shows the Market Year Average Price from USDA NASS, and from 2016 through 2027 shows the assumptions made by the Congressional Budget Office (CBO) for future Market Year Average prices. The low prices have led to farmers needing to take on more debt in order to continue operating. As such, producers' debt to asset ratio's have grown rapidly recently. The chart below lays out the degree to which producers have taken on debt. Over 8 percent of wheat producers are considered by USDA's Economic Research Service to be "highly leveraged" and 16 percent are considered to be "extremely leveraged."



The economic conditions of the past few years have also contributed to a drop in planted wheat acreage, which is generally predicted to continue moving forward. Plantings for 2016-2017 winter wheat are at the lowest level since 1909, a time when farmers were working with a horse and plow. Spring wheat planting is expected to be down as well, and we anticipate overall planted acres of wheat will be at historically low levels this year.



The chart above shows historic and projected future plantings of wheat. The 2002-2016 timeframe shows the actual planted acres, as published by USDA's National Agricultural Statistics Service (NASS). The 2017-2027 data points show the anticipated future plantings of wheat as published in the January 2017 Congressional Budget Office (CBO) baseline report. CBO anticipates that there will be a small swing back up in acreage, but this still exemplifies the challenging conditions facing growers of wheat when they pull back their production and shift to other crops.

Writing the next Farm Bill

The last Farm Bill was estimated to have reduced spending by $23 billion over ten years, at the time of passage. Since then, Farm Bill programs have cost less. The recent CBO baseline estimates that Farm Bill programs cost about $100 billion (over ten years) below what was originally estimated. These programs have performed well. But it also means this Committee will have a smaller baseline for writing the next Farm Bill, even though there is a growing need for improving farm support programs which will require additional baseline. NAWG recently joined with a broad array of organizations, including those represented here, in sending a letter to the House and Senate Budget and Appropriations Committees laying out the economic conditions in farm country and laying out the case for more resources for writing the next Farm Bill than are available under the most recent CBO baseline. We want the Agriculture Committees to have the resources necessary to write programs that meet producers' needs.

Agriculture Risk Coverage (ARC) program

One of the higher profile issues we encountered during implementation was significant disparities in payment rates in the ARC-County program between neighboring counties in some areas of the country. ARC-County was, of course, designed in a way where there would be differences in payment rates as it's a county-based program. Payment rates will inherently vary across the countryside depending on the growing conditions in particular counties. However, we have concern about the data that the Farm Service Agency uses to make yield determinations.

The FSA has administratively taken the approach of first utilizing data from the National Agricultural Statistics Service (NASS). This data is gathered through voluntary producer surveys, and if NASS is unable to obtain at least 30 responses from producers in a county then the agency won't publish a yield for that county. If NASS is unable to publish a yield, FSA will then utilize a cascade of other data sources, including Risk Management Agency (RMA) data, regional NASS data, or a determination made by the state FSA director. As this sort of situation could happen in a particular county inconsistently over time, that could mean that the data used to establish a county's benchmark yields and the actual yield for the year in question could come from multiple sources; this is like comparing apples to oranges. To address this issue, our producers believe that using RMA data as the first data source would provide more assurances of the accuracy of the data that's being used, and subsequently the integrity of the payment rates established for ARC-County. We recognize that there will still be disparities in payment rates between counties, but utilizing more reliable data will help to instill more confidence in our producers that they are getting fair treatment from the program.

Much of wheat country is in very rural areas with large counties where weather and growing conditions can vary widely from one part of the county to another. This dynamic was part of the

reason the last Farm Bill included ARC-Individual coverage (ARC-IC). As ARC-IC only applies on up to 65 percent of a participants' base acres, it is less attractive than participating in ARC-County. An option to improve the functionality of ARC-County could be to explore smaller-than-county sized geographic areas, like crop-reporting districts, that could be utilized for establishing payment rates. This approach could enable payments to be triggered at a more localized level and to be more reactive to the actual experience of producers.

Our producers acknowledge the political and budgetary considerations at play in writing the last Farm Bill, and the subsequent need to shift payments under the Title 1 programs until after the subsequent fiscal year after the crop year has concluded. However, there are multiple negative ramifications at the farm level as a result of this budget move. The seed and fertilizer bills don't wait until a year after the crop is harvested before they come due. Additionally, when I go to the bank to prepare to plant a crop, it's nearly impossible to predict a year and a half in advance what the assistance I might be eligible for will look like; as a result I can't accurately predict my cash flow. That has a big negative impact on my ability to get financing. It would be beneficial for you to explore the possibility of moving up the timeframe for program payments, or to maybe explore the possibility of making advanced partial payments.

Price Loss Coverage

A larger percentage of wheat base acres were enrolled in Price Loss Coverage (PLC) as compared to some of the other major commodities, like corn and soybeans. About 43.5 percent of wheat base acres are enrolled in PLC. The recent Congressional Budget Office (CBO) baseline, in projecting the costs of USDA programs over the next ten years, assumes that Congress will allow for a producer re-election after the expiration of the current Farm Bill and that 80 percent of base acres will enroll in PLC. This is anticipated as lower prices of the past couple of years will begin to be incorporated into the ARC benchmark, ultimately reducing the benchmark revenue.

From NAWG's perspective, this means that it will be important to adjust the ARC formula to enable it to continue to be functioning as a safety net when the need is there. It also means we need to ensure the PLC reference price is set at a level that provides a sufficient safety net when prices are at perpetually low prices.

NAWG urges Congress to increase the PLC wheat reference price to a level that is tied to cost of production. To make PLC as effective as possible, an appropriate measure for a reference price should be what it costs to produce the crop. We feel this would be a fair way to set support levels and to provide relatively proportional levels of support.

Producer Choice

The 2014 Farm Bill rightly included a producer choice between revenue protection and price protection as part of the process of replacing the previous direct payments program. NAWG supports maintaining a producer choice between revenue and price protection as part of the next Farm Bill.

In general, the ARC and PLC programs have been working as they were intended to work and they have been providing a key safety net for producers across the country. We were pleased at

the speed with which the Farm Service Agency (FSA) was able to implement the new programs and to make them available to producers beginning with the 2014 crop year. Moving forward, we believe these programs need to be enhanced for wheat to address the highly leveraged situation they now find themselves in, as indicated in the previous chart.

Other Title 1 Issues

Wheat growers are heavily reliant upon our export markets, with half of our crop being shipped out. As such, it's critically important to our growers that we have a level playing field internationally in which to sell our wheat, and that includes ensuring we have an international arbiter of rules. The World Trade Organization (WTO) framework isn't perfect, but we think it's important that all member countries abide by WTO rules, including ourselves. We applaud the work the House Agriculture Committee has done to bring attention to the rules violations that have been committed by countries like China, whose policies have been shown to cause U.S. wheat farmers to lose out on roughly $650 million a year. But we also strongly urge you to write legislation that provides a safety net that doesn't violate our trade commitments. We believe the current system of tying payments to a producers' recent historical production should be continued.

Crop Insurance – What's Working and What's Not Working

The federal crop insurance program has been and continues to be farmers' most important risk management tool. The current structure of the program, which requires a farmer to pay a premium, the cost of which is shared with the federal government, and the producer has to suffer an indemnifiable loss before they get any sort of payment.

Crop insurance is very popular with producers. For the 2015 crop year, there 56.8 million acres of wheat grown in the United States (according to USDA's Economic Research Service (ERS)), of which 49.4 million acres (or 87 percent) were insured (according to USDA's Risk Management Agency Summary of Business document, as of March 20, 2017). This high participation rate is indicative of the effectiveness of the program.

The last couple of years have been particularly difficult for wheat farmers. Crop insurance has played an important role in helping producers get through the current low prices. Each year there will inevitably be producers in some part of the country that experiences weather conditions outside of their control that could take out their crop. Crop insurance is critically important to enable a producer to farm another year after such an experience.

NAWG opposes any efforts that would undermine the current structure of the program. Specifically, we oppose any restrictions on eligibility for program participation based on a producer's Adjusted Gross Income, any caps on the federal cost-share level, and any restrictions on a producer's ability to utilize the Harvest Price Option (HPO). Restrictions on eligibility would cause farmers to lower their crop insurance participation which would not only cause the producer to take on more risk, but it would also cause premiums for all producers, big and small, to increase. If producers lower their coverage or if fewer producers are participating, that means there are fewer acres over which to spread risk in the program, ultimately requiring premiums to increase.

In addition to supporting the current structure of the producer support component of crop insurance, NAWG also opposes any cuts to the delivery system. The current public-private partnership for program delivery to producers has worked very well and has ensured that producers can get timely assistance when economic or weather disasters strike. Efforts to reduce the target rate of return or the Administrative and Operating (A&O) reimbursements would negatively affect crop insurance companies and their ability to deliver programs, and would thus have a negative impact on producers. The federal crop insurance has also performed incredibly well, with an improper payment rate of just 2.2 percent, which is about half the government-wide average of 4.39 percent. NAWG urges you to exclude any of these types of proposals.

Wheat producers have experienced a few issues over the past couple of years that warrant discussion.

Yield Exclusion

NAWG was very supportive of the inclusion of the Yield Exclusion provision as part of the last Farm Bill. When the Farm Bill was being written, many producers were suffering periods of prolonged drought. The Yield Exclusion provision enables producers in a county that had yields with a 50 percent or greater hit to be able to exclude that year's yield from their Actual Production History. We were, however, disappointed that USDA was unable to implement this provision for the 2015 winter wheat crop. Members of the House Agriculture Committee were true champions of wheat during that time when you raised this problem with USDA officials. Though the Department was still unwilling to have the provision apply to that year's crop, the Committee's attention to this issue undoubtedly drove USDA to quickly move forward with implementation for spring-seeded crops that year and subsequently the 2016 winter wheat crop.

Non-convergence in the HRW futures market

I'm a Hard Red Winter (HRW) wheat producer in western Kansas. Last year, our planted acres were down but we still had a crop that exceeded our previous yield record by over 10 bushels per acre. We had a much bigger crop than expected. This had a lot of implications for the markets. Where were we going to not only ship our wheat, but where were we going to store it in the interim? There were and continue to be significant logistical issues associated with the huge crop. This was just exacerbated by big crops in other large-producing countries, like Russia which was the largest producer last year. We had significant competition in our export markets from other countries whose wheat was relatively less expensive than U.S. wheat in part because of the relatively high value of the U.S. dollar. These economic forces have been part of the cause of the depressed prices.

At harvest time, as is the case for any crop, there is generally immediate downward pressure on prices because everyone is delivering to the market right from the field at the same time. So we'll often experience a growing divergence in the local cash price as compared to the futures market; the difference is referred to as the basis. Producers of HRW experienced a much wider basis than what we've experience in a long time. Personally, my local basis jumped from $0.70 a bushel to $1.55 a bushel in just ten days. This was a dramatic nose-dive in my local cash price.

There are several different options that can be explored to address this non-convergence issue that I don't need to get into here, but I think this committee should be aware of the crop

insurance implications of this problem. For HRW producers with revenue coverage, their contract is based on the Kansas City futures price. When the local cash price was $1.55 below the futures price, had I sold the crop and tried to pursue an indemnity, my contract would've only reflected that I was receiving the futures price rather than the actual price. In essence, my "actual" revenue was significantly inflated compared to my real experience. There are similar implications for the ARC program, in that the ARC formula utilizes a market year average price, which wouldn't account for farmers experiencing a wide basis.

NAWG has been exploring this issue to identify whether there are components of the crop insurance program that can be adjusted to make the program more reactive to what the farmer is actually getting paid for their crop. As we continue with this process, I will keep in touch with you and the rest of the Committee.

Quality Adjustments

Our wheat markets set strict standards for quality. And wheat tends to be more susceptible to quality problems than many other commodities. There are technologies in place to assist producers in producing the best quality of wheat anywhere in the world, but we are still dependent upon favorable growing conditions. This year, two of the more high profile issues our growers experienced were low Falling Numbers and vomitoxin in the northern Plains.

Many producers have suffered from widespread financial losses due to weather-induced problems resulting in poor end-use quality as measured by low Hagberg-Perten Falling Numbers. The Falling Number test detects starch degradation due to alpha-amylase enzyme activity and possibly other factors in wheat flour. This ultimately indicates that the flour has poorer quality for baked goods. Farmers experiencing low Falling Numbers will likely receive a discount at their elevator, often significant depending on the degree to which their load was affected. Additionally, with low Falling Numbers, though the quality has taken a hit, it isn't a yield issue. In fact, the producers in Washington, Idaho, and Oregon that experienced this problem had bigger than average yields. However, the way the statute is written, those quality discounts are applied to a producer's Actual Production History (APH); even though low Falling Numbers doesn't directly affect a producer's yield, RMA still requires that their yield be reduced to reflect that quality loss. This occurs even if the producer doesn't pursue an indemnity. From a fairness standpoint, it would be worth looking into whether such quality discounts could be applied to the price side of the equation rather than the yield side so that a producer's APH isn't affected for 10 years until that year's yield is cycled out.

Conservation Compliance

NAWG continues to have serious concerns about linkage of conservation compliance to crop insurance. NAWG supports a strong crop insurance program as part of the farm safety net and believes that growers should be encouraged to purchase crop insurance. Additional requirements to obtaining crop insurance, such as the conservation compliance requirements added in the 2014 Farm Bill serve as a disincentive to purchase crop insurance. NRCS continues to have a backlog of wetland determinations, with over 2500 awaiting review in the prairie pothole region at the beginning of January. NAWG supports voluntary conservation programs included in the Farm Bill that work with producers on their land in production to help them adopt conservation practices to improve natural resources and farm productivity.

Conclusion
Ultimately, wheat farmers and all of agriculture are suffering some of the toughest economic conditions we've had to deal with since the 1980s. The political and policy dynamics facing Congress this year are much different than the process to write the last Farm Bill. A strong safety net and risk management system is needed now more than ever. At the same time, it doesn't matter whether farmers are getting record prices or if they're bottoming out. The risks that farmers take every year in putting a crop in the ground requires there to be an effective risk management system and safety net in place to offset some of that risk in order to protect against the inevitable weather disaster or price drop. Crop insurance and the Title 1 programs have proven to be effective and good policy in general.

For many Farm Bills, Congress has asked commodity groups to work together to come up with consensus on policy topics in the Farm Bill. The attached document is the beginning of that collaborative process. Farm and commodity organizations sent a letter to the Senate Budget and Appropriations Committees pointing to the sharp fall in farm prices and income since 2013 and asking Congress to provide additional funding in order to develop an effective farm income safety net in the 2018 Farm Bill. A number of these organizations have met to discuss specific issues that need to be addressed in the next farm bill and will continue to work to develop consensus proposals to share with the Agriculture Committees on potential ways to resolve them. The following organizations are in agreement on the attached initial list of positions. To be clear, the beginning of this document covers only those issues where there is a consensus on every issue.

As our discussions continue and as guidance from the Committees is provided, we hope to expand this list to cover additional issues expected to be considered during negotiation of the new Farm Bill.

As you continue your series of hearings, I look forward to working with you to write the next Farm Bill. I also urge you to move quickly with Chairman Conaway in this process to ensure a full reauthorization bill can be completed prior to the expiration of the current Farm Bill on September 30, 2018, so that producers have certainty about the structure of the safety net moving forward.

With that, I'll be happy to answer any questions.

FARM BILL ISSUES ON WHICH WE AGREE

March 24, 2017

On March 15, 2017, farm and commodity organizations sent a letter to the Senate Budget and Appropriations Committees pointing to the sharp fall in farm prices and income since 2013 and asking Congress to provide additional funding in order to develop an effective farm income safety net in the 2018 Farm Bill. A number of these organizations have met to discuss specific issues that need to be addressed in the next farm bill and will continue to work to develop consensus proposals to share with the Agriculture Committees on potential ways to resolve them. The following organizations are in agreement on the attached initial list of positions. To be clear, the beginning of this document covers only those issues where there is a consensus on every issue.

As our discussions continue and as guidance from the Committees is provided, we hope to expand this list to cover additional issues expected to be considered during negotiation of the new Farm Bill.

Overarching Issues:

Increase funding in the 2018 Farm Bill in order to address the significant reductions in farm prices and income incurred since 2013, and to meet other critical needs.

Federal crop insurance and commodity programs are our top funding priorities.

Commodity Programs:

Continue a counter-cyclical program like the Price Loss Coverage (PLC) program and a revenue program like the Agricultural Risk Coverage (ARC) program.

Change the ARC and PLC programs to make them more effective and fairer to all farmers.

If the ARC and PLC programs continue, farmers must be allowed to re-elect and re-enroll on a crop by crop basis.

Commodity program payments should be based on recent historical crop production rather than on current year planting.

Crop Insurance Programs:

Oppose reducing premium discounts.

Conservation Programs:

Maintain strong funding for federal conservation programs which preserve environmental benefits, while continuing the prioritization of working lands conservation programs.

Maintain strong funding of the Environmental Quality Incentives Program (EQIP) and the Conservation Stewardship Program (CSP).

Examine the rental rates of the Conservation Reserve Program (CRP) and the Conservation Reserve Enhancement Program (CREP) annually at enrollment to ensure they mirror the rental rates of comparable land in the immediate area.

Improve State Technical Committees to make them more ag-friendly by encouraging producers' participation and input.

Other Programs:

Ensure adequate funding for agricultural research and education.

Continue work on simplifying procedures, reducing paperwork requirements and streamlining interactions between the Farm Service Agency (FSA), the Natural Resources Conservation Service (NRCS) and the Risk Management Agency (RMA) via the Acreage Crop Reporting Streamlining Initiative (ACRSI).

Continue and work to improve the Young and Beginning Farmer Programs implemented in the 2014 Farm Bill.

American Farm Bureau Federation
American Soybean Association
National Association of Wheat Growers
National Barley Growers Association
National Corn Growers Association
National Farmers Union
National Sunflower Association
U.S. Canola Association

Future Farm Policy Work:

On several other issues, more than a majority of the organizations are in agreement, but one or two have conflicting policy statements. We plan to continue to work towards agreement, but rather than another consensus document, we hope to "negotiate" some of those differences in future meetings and provide additional input to Congress.

Note: The National Cotton Council, Southern Peanut Farmers Federation and USA Rice have also participated in these discussions but do not have sufficient policy yet to support these provisions. All three of those groups, as well as those listed on this statement, intend to continue to work together to see if we can come to further agreements on these and other 2018 farm bill issues.