Mr. Chairman, Senator Harkin, and Members of the Committee, I am pleased to appear before you today at this oversight hearing for the Federal Crop Insurance Program. Here today with me is Dr. Keith Collins and Mr. Ross Davidson. Dr. Collins, the Chief Economist of the Department of Agriculture, also serves as Chairman of the Board of Directors the Federal Crop Insurance Corporation (FCIC). Mr. Davidson is Manager of the FCIC and Administrator of the Risk Management Agency (RMA) that oversees the Federal Crop Insurance Program.

Introduction

The Federal Crop Insurance program was first instituted in 1938. Crop insurance, as we have traditionally called it, and now more recently other types of risk management tools, have become an increasingly important part of the economic safety net for American agriculture. They are an expanding component, alongside the several other farm programs that include marketing assistance loans, direct and countercyclical payments, dairy price support and payments, and other specialty commodity programs.

As the world has become more technical and interconnected, the risks faced by farm businesses also have increased and become more complex. In addition to the always-present natural risks (diseases, insects, aberrant weather), market risks have expanded, new risks have emerged such as liability related to consumer safety, the loss of irrigation waters due to competing demands, and now we have the threat of intentional sabotage of the food system.

Policy Role of Risk Management

The Federal Crop Insurance Program has grown rapidly in the past few years in response to the changing risk environment. Insurance not only protects farms from devastating loss in times of extreme weather such as extensive drought or flood, but it protects individual farming operations from adverse impacts of more localized conditions as well. More and more producers have recognized that it is just good business to have crop insurance, and commercial lenders increasingly require producers to have crop insurance as a condition of obtaining a loan. Today over 80 percent of acres for major program crops are covered by crop insurance. And, more than half of those acres have elected coverage at the 70 percent level or above.

Since passage of the Agricultural Risk Protection Act of 2000 (ARPA), RMA has placed a high priority on extending coverage to a wide array of products including: specialty crops, forage, rangeland, livestock and even aquaculture.

Today, RMA has insurance products in pilot phase or under development for the majority of specialty crops. Other products, such as Adjusted Gross Revenue, which are nearing the end of their pilot stages, will provide risk management tools for most specialty crops and an increasing portion of the livestock and livestock products markets as well.

RMA also has programs that provide specific protection for certain classes of livestock and for forage and rangeland. These products are still pilot programs and while they are in their infancy, the FCIC Board is moving judiciously to ensure that they effectively and safely meet demonstrated market needs and can be operated with actuarial soundness.

However, government provided risk management tools are fundamentally different from the traditional farm programs. They are a unique entity on the spectrum of agricultural policy tools. They are unique in several respects, and the Congress recognized this with passage of the ARPA in 2000.

The vision at that time of some of the architects of the ARPA was for risk management, at some point in the future perhaps, to constitute the major component of the safety net for the commercial farm sector, supplanting some of the more traditional farm programs. The ARPA provided the structure for the envisioned expansion of risk management tools--both the development of new, innovative tools and their widespread use across more of the farm sector.

Risk management also is unique in that it is actuarially based--it is not another farm program with an often negotiated or bureaucratically determined set of rules for providing benefits. Rather, it is a program providing individual producer protection with costs and benefits based upon historical experience and evaluations of specific risks. Congress has required actuarial soundness, meaning that the amount collected from premiums roughly equals the amount paid out for claims over time. Producers pay for their insurance coverage, which is provided through commercial contracts between the producer and a private sector insurance company. Insurance companies deliver the products, make indemnity payments and bear a portion of the commercial risk.

Public-Private Partnership

This component of the farm safety net also is unique in that it involves this unusual private-public partnership in making risk management services available to American producers. It involves the participation of private companies--some dozen and a half today--in both development and delivery of the service to farmers. At the same time, it involves the participation of a major government agency, the RMA within the Department of Agriculture.

ARPA placed the RMA in a unique position of being both a regulator of the agriculture insurance industry and a reinsurer of billions of dollars of incurred liability annually. And, the partnership involves broad industry representation through an oversight board--the FCIC board--whose composition was determined by the Congress with individual members selected by the Administration. The nature of this unique partnership still is evolving.

We now are in the fourth year since enactment of ARPA. This hearing thus is very timely, presenting a good opportunity to review progress and performance since ARPA's passage and also to assess any technical or structural changes that may appear warranted.

The Challenge Ahead

U.S. agriculture today counts some 2.1 million places as farms, together producing about $200 billion of products annually. This highly productive farm sector is widely diverse, producing the traditional row crops that long have been the focus of farm policy, horticultural crops of even greater value, and a large livestock output. All of this is from a highly differentiated farm structure that encompasses a large number of small, diversified farms, a small number of very large specialized farms, and a wide variety in between.

It is these farms of widely differing structure and economic circumstances that RMA attempts to provide risk management tools for improved farm management.

Today, risk management tools, still largely crop insurance, cover only about $38 billion of the $200 billion of value generated each year. And, they still are largely focused on the traditional large acreage field crops. But, demand is growing for tools that can provide a safety net for farms and products that receive little or no benefits from traditional farm programs.

The challenge to the insurance industry and to RMA is clear. More products are needed that address the differing risk environments of the different farm types. More products are needed for the rest of the crops sector, and we have only begun to develop appropriate products for the livestock sector.

But, these products must fit the needs of the different farms across differing regions. And, they must be affordable, delivered efficiently, and provide timely benefits, as required.

Program Integrity

The RMA also has a particular challenge in maintaining the integrity of the risk management tools. They are not farm programs but structured on an actuarial basis, not very amenable to mid-course adjustments. They are subject to abuse and require greater vigilance to prevent their misuse.

Ad Hoc Disaster Versus Risk Management

One other challenge, one confronting the Congress especially in providing risk protection to farmers, is determining the relative roles of ad hoc disaster assistance versus the risk management tools of the Program, especially crop insurance. The presence of a Federally administered insurance program does not guarantee that disaster payments will never be needed, but it can reduce the extent and frequency of disaster assistance over time.

Likewise, the requirement in the recent disaster legislation that uninsured producers receiving a payment purchase buy-up insurance for two years is appropriate discipline to ensure that crop insurance serves the primary role of providing disaster assistance. Traditionally, the disaster legislation also has favored those who had crop insurance with a slightly higher payment rate.

The recent drought of 2002 demonstrates the impact that crop insurance has had in managing risks. Over $4 billion in claims have been paid to date - most of them were paid within 30 days of the evaluation of the loss. While Congress also passed a substantial disaster package for that period, the $4 billion paid in crop insurance claims represents a substantial and growing portion of all disaster payments. Furthermore, the premiums paid by producers reduced total outlays of the Federal government. As crop insurance is used more extensively and as more risks, commodities and areas are afforded coverage, the need for disaster assistance should decline.

Summary

We are working diligently to implement the ARPA as the Congress directed. We have gained considerable experience which we believe will prove invaluable as we move forward. We welcome continued discussion with the insurance industry, farmers and ranchers and the Congress as we attempt to refine and improve this increasingly important part of the farm safety net. We look forward to working with this Committee.

Thank you.