Statement by Eldon Gould
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United States Department of Agriculture
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Introduction

Mr. Chairman and members of the Subcommittee, I am Eldon Gould, Administrator of the Risk Management Agency (RMA). I am a life-long farmer in northern Illinois, with a 1,500-acre corn, soybeans and wheat farm and a 700 sow farrow-to-wean hog operation.

I appreciate the opportunity to explain the role of the Federal crop insurance program as it relates to the financial risks to Federal and private insurers covering production agriculture.

Background

First, I would like to provide some background about the Risk Management Agency and its objectives. Some of you may know our structure and mission very well, while others may have only limited knowledge of our role with crop insurance.

As a vital part of USDA, the Risk Management Agency plays an essential role in American agriculture by promoting, supporting and regulating sound risk management solutions to preserve and strengthen the economic stability of America's agricultural producers.

RMA oversees and administers the crop insurance program via the Federal Crop Insurance Corporation (FCIC) led by its Board of Directors (Board). The FCIC reinsures the policies sold to American farmers by private insurance companies approved to participate in the delivery of the Federal crop insurance program. The agency has a unique partnership with 16 private insurance companies that are responsible for the sales, service and loss adjustment of the various insurance policies.

Under the direction of the FCIC Board, RMA provides new and innovative insurance products to the agricultural community, validates the utility of current insurance products, ensures outreach to small and limited resource farmers, promotes equity in risk sharing and guards against fraud, waste and abuse within the program.

Risk management tools extend beyond crop insurance, and include a variety of risk management options and strategies developed to assist producers in mitigating the risks inherent in agricultural production. Risk management may include: financial management tools to mitigate price and production risks; tools to enhance measurement and prediction of risks in order to facilitate risk diversification; and tools to improve production management, harvesting, record keeping or marketing.

Crop insurance is the government's principal means of helping farmers survive a major crop loss. It is also extremely useful to agricultural producers even when it is not paying losses. More and more, we see that crop insurance enables producers to secure approval of their

operating loans, aggressively market a portion of their crop and allow them to plan more reliably for their future.

For 2006, the Federal crop insurance program provided producers with nearly $50 billion in protection on approximately 242 million acres through about 1.1 million policies. There are 21 plans of insurance available and nearly 30 new insurance products under various stages of evaluation or development. Approximately 80 percent of acres of major program crops are insured, with many at levels of coverage equaling 70-85 percent of potential crop value.

USDA Response to GAO Report Recommendations

Regarding the recommendations contained in the GAO Report (07-285 Climate Change), RMA agrees with the need to analyze the long-term implications of climate change for the crop insurance program. We are particularly interested in the Intergovernmental Panel on Climate Change (IPCC) 4th Assessment Report, which was released on April 6 and a report of the U.S. Climate Change Science Program (CCSP) that is expected to be released in December 2007. This IPCC report provides a rigorous assessment of what is known with regard to climate change impacts, adaptation and vulnerability.

As William Brennan, Director of the U.S. Climate Change Science Program stated, "This is a valuable report that our nation has contributed to in important ways through investments in observations and research." With regard to agriculture in North America, the IPCC report concludes that "moderate climate change in the early decades of the century is projected to increase aggregate yields of rainfed agriculture by 5-20%, but with important variability among regions. Major challenges are projected for crops that are near the warm end of their suitable range or depend on highly utilized water resources."

The Department of Agriculture is also an important contributor to the U.S. Climate Change Science Program. USDA is the lead agency for a CCSP Synthesis and Assessment Report on the Impacts of Climate Change on Agriculture, Land Resources, Water Resources and Biodiversity that is expected to be completed in December 2007. A primary goal of the report is to enhance our understanding and ability to estimate impacts of future climate change on these systems and resources in the United States. This report is being prepared by the Department's Global Change Program Office.

As RMA proceeds in its analysis of climate change, it is worth noting that any analysis will be complicated by the fact that agricultural technology is continually progressing, resulting in a decrease in risk from weather events (e.g. drought tolerant corn).

Although USDA agrees with GAO's recommendations, we caution that much of the focus of this report is with losses related to coastal weather events, especially hurricanes. However, the main causes of catastrophic losses for the crop insurance program are drought, excess moisture, freeze, etc. in the nation's interior. This is why the loss experience of the crop insurance program is distinct from the loss experience described in the report for the National Flood Insurance Program and property and casualty losses for private insurers.

In 2004, crop insurance provided approximately $3.2 billion in indemnity payments to farmers and ranchers, including approximately $218 million for the four hurricanes in the Southeast and approximately $337 million for a brief freeze in the upper Midwest. For 2005, indemnity payments totaled approximately $2.4 billion, with hurricane-related losses accounting for $234 million of the total. During the period 1996-2005, hurricanes accounted for approximately 2 percent of losses paid under the Federal crop insurance program. In 2005, one of the more active hurricane years, approximately 10 percent of program losses paid were related to hurricane damage. (See Figure 3.)

Much of the increase in crop insurance indemnities over time reflects the rapid growth of the crop insurance program, rather than an increase in either the frequency and/or severity of catastrophic weather events. In 1980, for example, total liability of the Federal crop insurance program was $3 billion, with insurance in force on about 21 million acres. By 2006, total liability had reached almost $50 billion, and insured acreage in excess of 242 million acres. The phenomenal growth in the program will quite clearly lead to much larger indemnity payments, as measured in dollars. Yet, the severity of loss for the crop insurance program, as measured by the loss ratio, has been generally lower in the 1990s and 2000s than in the 1980s. RMA's loss ratio for 1980-1993 was 1.58, while from 1994-2006 it has been 0.88. (See Figure 2.) This most likely relates to the generally good growing conditions experienced in many of the major crop areas for production agriculture as well as improved methods for establishing premium rates.

USDA does take prospective actions to assess potential increases in program risk associated with changes in weather and production agriculture. RMA continually analyzes available information to look for ways to improve its rating and program assessments. Currently, RMA tracks total program liability, a definitive measure of the total value at risk from climatic weather events, and updates this information on a weekly basis available on our public website.

RMA also estimates expected changes in liability up to 10 years ahead through RMA's budgetary baseline projections. In addition, RMA can assess the long-term, as well as current, exposure of the crop insurance program to catastrophic weather events as GAO has pointed out with regard to a recurring 1993 loss (i.e. flooding in the Mississippi River Valley).

When GAO surveyed private insurers about what they are doing to estimate and prepare for the risks of climate change, it found that insurers were using catastrophe models that incorporate the hurricane cycle. RMA also incorporates hurricane risk into premium rates for several of its insured commodities. However, rather than focusing on short-term fluctuations in the hurricane cycle, RMA uses historical hurricane data that spans several cycles, which is not dissimilar to how predictions centers, like Colorado State University, make use of such data. This is because RMA does not face the risk of insolvency, as do private insurers, should an unexpectedly large loss event occur. As a result, private insurers expend considerable time, money and resources on strategies to appropriately manage the attendant insolvency risk following catastrophic events, including larger reserve factors and preemptive rate loadings. The respective risks of bankruptcy account for much of the differences in approach to climate change on the part of private insurers as compared to public insurers, such as RMA.

New Crop Insurance Products: Pasture, Rangeland and Forage Pilot Program

Obviously, changes in weather patterns play a role in the Federal crop insurance program. Recognizing this role, FCIC is moving the Federal crop insurance program forward in adopting new technologies. For example, FCIC recently introduced a pilot insurance program for pasture, rangeland and forage that relies on weather station data and satellite imagery to monitor plant growth and determine insurance payments.

These new insurance tools will help farmers and ranchers, especially those with operations located in drought-impacted areas, to improve their risk management capabilities. Designed to operate in a variety of range and pasture environments, these products utilize innovative technology to determine when a producer has suffered a loss.

The Rainfall Index insurance program is being pilot tested in 220 counties in Colorado, Idaho, Pennsylvania, South Carolina, North Dakota and Texas and is based on rainfall indices as a means to measure expected production losses. The Vegetation Index insurance program is being pilot tested in 110 counties in Colorado, Oklahoma, Oregon, Pennsylvania, South Carolina and South Dakota and is based on satellite imagery that determines the productivity of the acreage as a means to measure expected production losses. Together, these pilot programs will be available to provide coverage on approximately 160 million of the 640 million acres of grazing land and hay land in the United States.

As of April 2, the sales of the new Pasture, Rangeland and Forage Rainfall Index and Vegetation Index pilot programs have exceeded first year sales projections. There have been 8,023 Rainfall Index policies sold covering over 24 million acres with over $328 million in total liability. The Vegetation Index pilot program's sales are at 1,687 policies sold covering over 3.9 million acres and $61.7 million in total liability. This puts participation in the pilot program areas at approximately 17 percent.

Conclusion

In conclusion, let me reiterate that RMA agrees with the GAO recommendations with regard to the need to analyze the long-term implications of climate change for the crop insurance program. RMA views the inclusion of new information and analysis as an opportunity to strengthen and improve the Federal crop insurance program.

As I have stated, Mr. Chairman, I am a producer myself and one of my goals as Administrator of RMA is to ensure that RMA is doing everything it can, within its legislated authority, to assist the farmer and rancher and keep rural America and its critical agricultural industry competitive and sound. We recognize that RMA is a critical component of the safety net for the business of agriculture in this country.

RMA continues to evaluate and provide new products and to promote the adoption of crop insurance as a risk management tool so that the government can further reduce the need for ad hoc disaster payments to the agriculture community.

The growth and effectiveness of the crop insurance program is dependent on a reliable delivery system; insurance products that meet the needs of producers; investment in information

technology to ensure the delivery system is timely, accurate and dependable; and adequate funding to support compliance and program integrity, maintenance and administration, product evaluation and new product development.

In 2007, we will continue to strive toward providing a useful, practical safety net for America's farmers and ranchers.

Again, thank you for the opportunity to participate in this important hearing. I look forward to responding to questions on these issues.

Figure 1

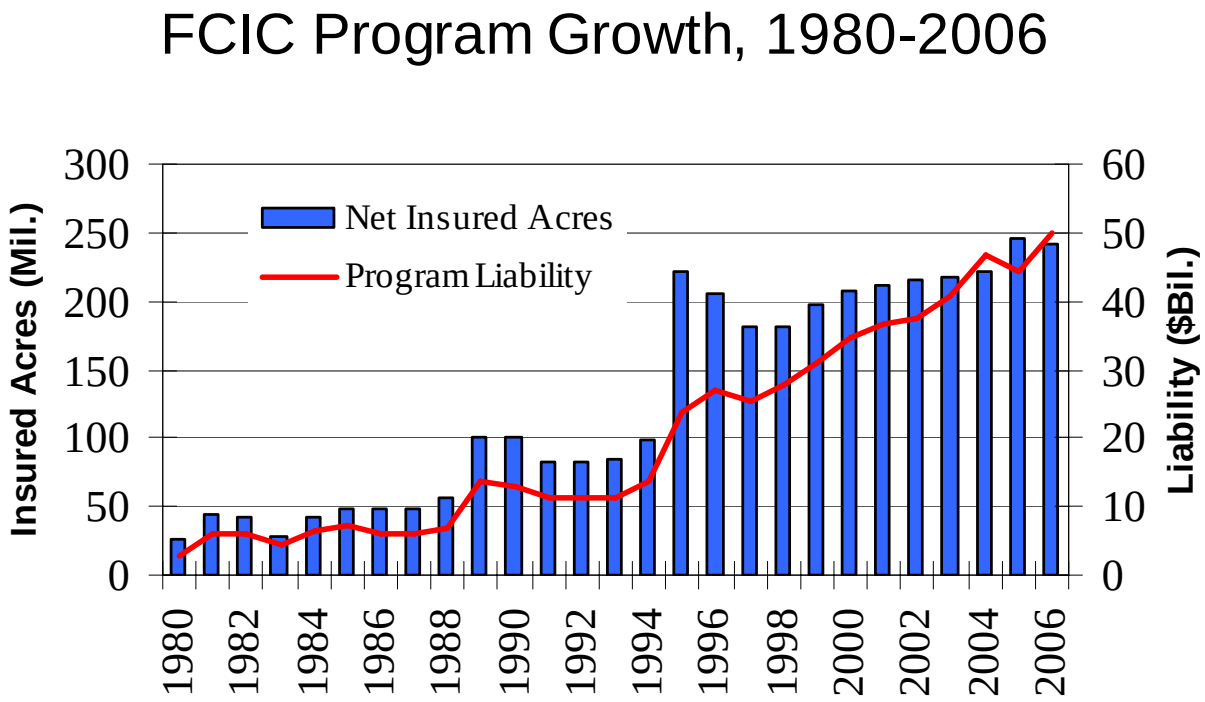


Figure 2

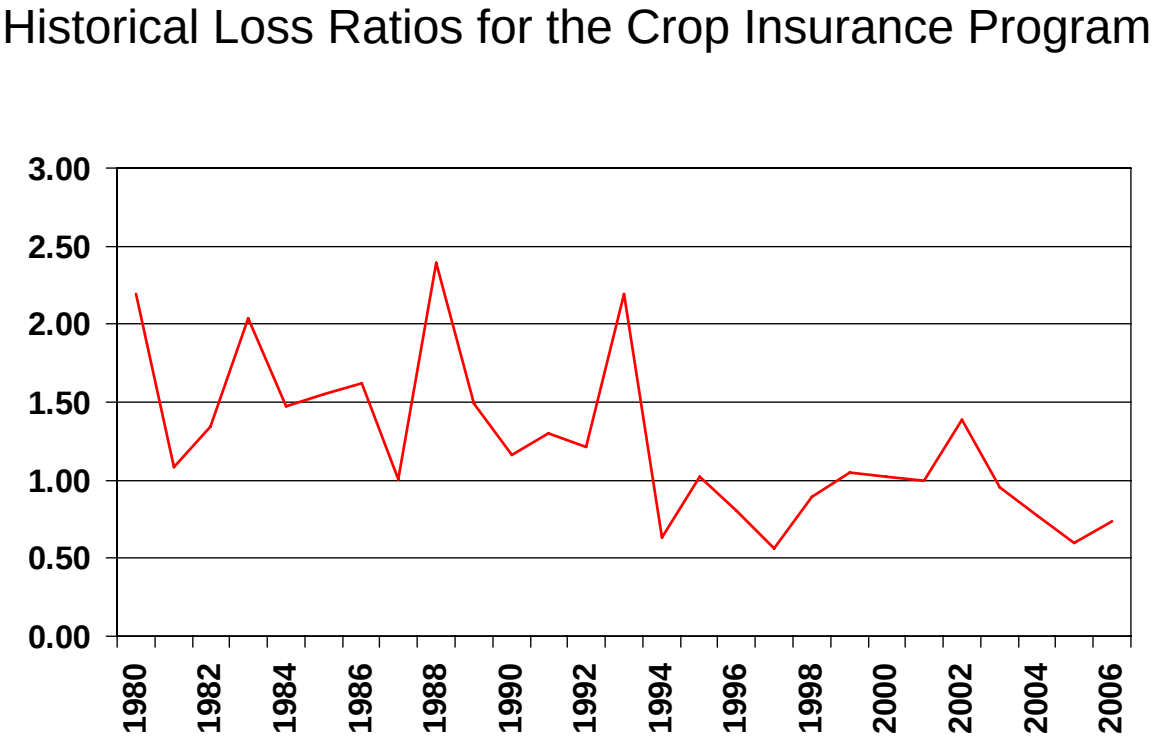
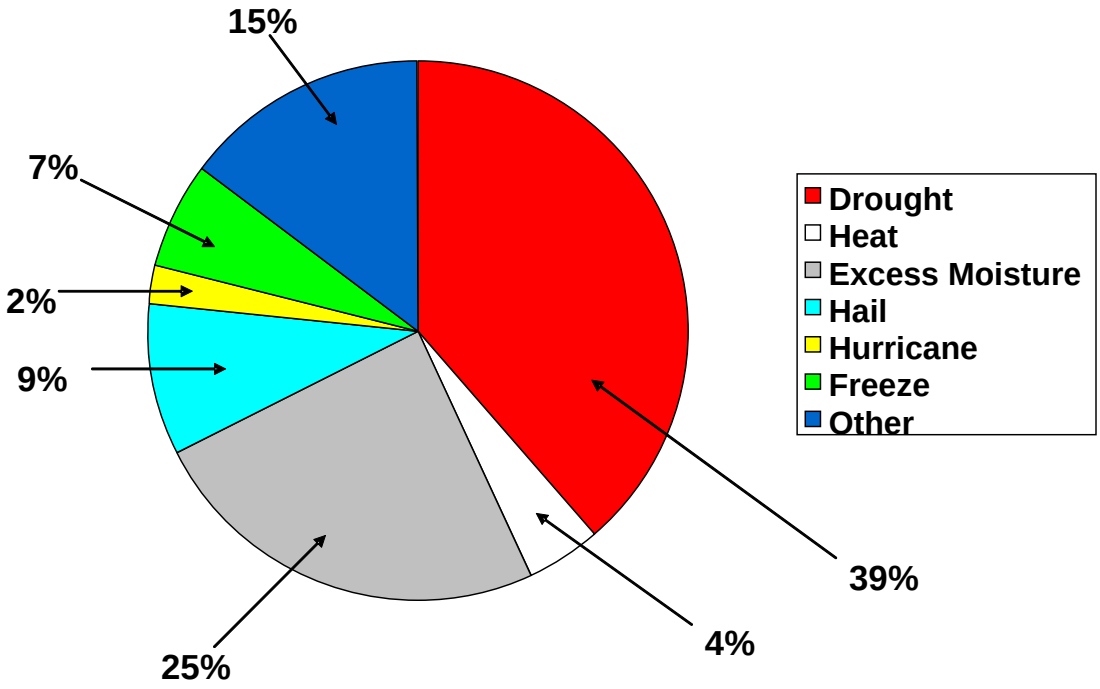


Figure 3

FCIC Causes of Loss, 1996-2005



FCIC Causes of Loss, 2005 Only