U.S. Department of Agriculture

Office of Inspector General
Great Plains Region

Audit Report

Methodology for Establishing National/Regional Loan Rates for USDA's Pulse Crop Loan Program

Report No. 03601-26-KC
September 2008

U.S. DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

Washington, D.C. 20250

September 25, 2008

REPLY TO
ATTN OF: 03601-26-KC

TO: Teresa C. Lasseter
Administrator
Farm Service Agency

ATTN: T. Mike McCann
Director
Operations Review and Analysis Staff

FROM: Robert W. Young /s/
Assistant Inspector General
for Audit

SUBJECT: Methodology for Establishing National/Regional Loan Rates and the Corresponding Repayment Rates for USDA's Pulse Crop Loan Program

This report presents the results of our audit of the Marketing Assistance Loans (MAL) and Loan Deficiency Payment (LDP) provisions for dry peas, lentils, and chickpeas (pulse crops),[1] made available for the first time through the Farm Security and Rural Investment Act of 2002 (2002 Farm Bill). The Office of Inspector General initiated this audit in response to a hotline complaint alleging that the Farm Service Agency (FSA) used incorrect posted county prices (PCP) to determine MAL repayment and LDP rates for dry peas.[2] The complainant also alleged that the pulse crop loan program has resulted in excessive payments to pea growers and caused planted acres of dry peas to dramatically increase. We evaluated whether the pulse crop MAL loan rates and repayment rates established by FSA conformed to the authorizing legislation and resulted in excessive program costs for pulse crops, particularly dry peas.

Our review disclosed that FSA did use proper PCPs and repayment rates as prescribed by law and has met Congress' goal of making pulse crops an attractive option for producers. However, based on its initial analysis of available production and price data, FSA concluded that loan rates established by the 2002 Farm Bill reflected food quality (U.S. No. 1 grade) rather than feed

---

[1] Pulse crops are edible seeds of annual legumes and are produced throughout the world. They include plants such as field peas, lentils, dry edible beans, chickpeas, soybeans, fenugreek, fababeans, and other minor plants. While soybeans technically can be considered a pulse crop, in the United States they are classified as an oilseed and reported as such. The pulse industry in the U.S. generally refers only to field peas, lentils, and chickpeas and we are referring only to these crops in this report.

[2] The loan repayment rate is the Commodity Credit Corporation (CCC)-determined market price, often referred to as the posted county price (PCP). The PCP is based upon market prices at appropriate U.S. terminal markets adjusted to reflect quality and location and are announced for pulse crops each Friday at 7:00 A.M. Eastern Time. The loan repayment rates are based on the previous week's market prices for each pulse crop, as CCC determines.

grade dry peas and U.S. No. 3 grade lentils. Therefore, FSA applied discounts to the established loan rates for lower quality dry peas and lentils. Industry officials presented Congress with several objections to the discounts, such as their belief that, by implementing them, USDA did not adhere to the Congressional intent of establishing MALs and LDPs for pulse crops. In response to these objections, Congress in the 2003 Consolidated Appropriations Resolutions (the 2003 Act) clarified its intent, mandating that the loan rates be based on feed grade dry peas and U.S. No. 3 grade lentil. FSA responded to the legislation by issuing 2003 loan rates with base quality of feed grade dry peas, U.S. No. 3 grade lentils, and small chickpeas and by terminating the loan discount schedule.

We determined that Congress' decision to terminate FSA's loan discount schedule resulted in the congressionally set loan rates exceeding the loan repayment rates for dry peas. As a result, dry pea producers received approximately $14 million in payments and marketing loan gains for crop year 2003 that would not have been paid if the loan discount schedule had been in effect. We also determined that the planted acres for pulse crops have increased significantly since the inception of the 2002 Farm Bill and the 2003 Act. The 2008 Farm Bill has since set lower loan rates for pulse crops for crop years 2009 through 2012.

Background

The 2002 Farm Bill[3] governed Federal farm programs for crop years 2002 through 2007 and continued the non-recourse MAL and LDP provisions of previous legislation. The 2002 Farm Bill authorized MALs and LDPs for dry peas, lentils, and chickpeas (pulse crops) available for the first time during the 2002 through 2007 crop years and established fixed national loan rates for each commodity. The MAL program provides producers with interim financial assistance at harvest, when crop prices are usually lower than at other times of the year. By doing so, the program effectively guarantees a minimum crop price for covered commodities. Producers can obtain a marketing loan after harvest by using their crop as collateral. FSA bases the loan amount on a statutory national loan rate it adjusts to reflect county variations in market prices across the country. Producers have the option to repay the loan with interest or forfeit the crop at the end of the loan period. Under the LDP component, in lieu of obtaining a loan, producers receive a deficiency payment that does not have to be repaid. The deficiency payment rate equals the amount by which the loan rate for the location where the commodity is stored exceeds the marketing loan repayment rate for the commodity.

The 2002 Farm Bill established crop years 2002 through 2003 loan rates of $6.33 per hundredweight (cwt) for dry peas, $11.94 for lentils, and $7.56 for small chickpeas. For crop years 2004 through 2007, the loan rates decreased to $6.22 per cwt for dry peas, $11.72 per cwt for lentils, and $7.43 per cwt for small chickpeas. The Joint Explanatory Statement of the Committee of Conference, attached to House Conference Report 107-424, which accompanied

[3] Public Law 107-171, May 13, 2002.

the 2002 Farm Bill, stated that the loan rate for dry peas was based on U.S. feed pea prices.[4] The loan rate for lentils was based on the price of U.S. No. 3 lentils, and the loan rate for small chickpeas was based on the price of chickpeas that drop below a 20/64 screen.[5] It also expected the Secretary to calculate the repayment rates based on the prices of feed peas, No. 3 lentils, and chickpeas that drop below a 20/64 screen.

Objectives

Our objectives were to evaluate whether the pulse crop MAL loan rates and repayment rates established by FSA were in conformance with the authorizing legislation and resulted in excessive program costs for pulse crops, particularly dry peas.

Scope and Methodology

As part of the field work performed between December 2006 and July 2008, we spoke with Department of Agriculture (USDA) officials from FSA's Deputy Administrator for Commodity Operations/Warehouse and Inventory Division and Economic and Policy Analysis Staff located in Washington, D.C.; Kansas City Commodity Office; the North Dakota State FSA Office; and the Ward County FSA Office located in Minot, North Dakota, to ascertain the methodology for establishing the loan, repayment, and LDP rates and the procedures for administering the MAL program for pulse crops. We also spoke with representatives of the USA Dry Pea & Lentil Council and the Northern Pulse Growers Association to obtain their opinions of the pulse crop program. We asked six judgmentally selected pulse crop producers why they elected to plant pulse crops and how they felt about the pulse crop program. We also contacted USDA's Office of the Chief Economist to determine the economic impact of the pulse crop program on prices, supply, demand, and crop carryover since it began in crop year 2002. We reviewed records, reports, and documentation supporting the methods used to establish national, regional, and loan repayment rates for dry peas, lentils, and chickpeas. We also reviewed applicable Federal legislation and regulations, and FSA procedures, notices, and news releases.

We conducted this audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

---

[4] In 2003, the pea industry requested that the Grain Inspection, Packers, and Stockyards Administration (GIPSA) establish standards for feed peas. On July 31, 2006, GIPSA issued a directive which provided procedures for grading feed peas and issued the Feed Pea Standard. The directive served as the official procedures and standards for feed peas. According to the directive, U.S. Sample grade are feed peas which (a) do not meet the requirements for grade U.S. No. 1; or (b) contain more than 15 percent moisture; or (c) contain .02 percent or more animal excreta; or (d) contain metal fragments, or broken glass; or (e) have a musty, sour, or commercially objectionable odor; or (f) are heat damaged or of distinctly low quality.

[5] The screen is used to sift aggregates during a grain size analysis.

Observations

Our review did not substantiate the hotline complainant's claim that FSA used incorrect prices to determine MAL repayment and LDP rates for pulse crops, particularly dry peas. FSA had implemented the pulse crop program in the manner Congress intended. By doing so, it made pulse crops an attractive option to producers. However, we did verify the claim that for crop years 2003 through 2005 planted acreage and production, LDP payments, dollar amount of loans made, and marketing loan gains for pulse crops have increased.

To provide producers with an incentive to grow pulse crops and, in turn, expand the program, the 2002 Farm Bill established loan rates for the 2002 through 2003 crop years of $6.33 per cwt for dry peas and $11.94 per cwt for lentils. These rates exceeded the pulse crop price data the National Agricultural Statistics Service (NASS) has collected since 1999. After the 2002 Farm Bill's passage, FSA began the process of calculating reasonable repayment rates for feed peas in the manner typical of all program crops. At the time, the Grain Inspection, Packers, and Stockyard Administration (GIPSA) based the U.S. standards for dry peas solely on the edible dry pea market. (GIPSA did not establish U.S. standards for feed peas until 2006.) Similarly, NASS' price information reflected market prices for edible peas. Relying on limited production and price data for the 3 previous years (1999, 2000, and 2001), FSA analyzed loan and repayment options, and concluded that the legislated national pulse crop loan rates were more indicative of food grade quality (U.S. No.1 grade) than feed grade dry peas and U.S. No. 3 grade lentils. FSA announced 2002 pulse crop loan rates on September 3, 2002, and stated that the congressionally set national loan rates for pulse crops would apply uniformly for U.S. No. 1 grade quality dry peas and lentils. FSA decided to apply a discounted loan rate to lower quality dry peas and lentils because price data collected by NASS since 1999 had not been above the congressionally mandated loan rates.

FSA applied the loan discounts based on its interpretation that the 2002 Farm Bill extended the Secretary's authority to adjust loan rates as permitted by the Federal Agriculture Improvement and Reform Act of 1996.[6] For crop year 2002, FSA set loan rate discounts of $.50 per cwt for U.S. No. 2 grade dry peas, $1.00 per cwt for U.S. No. 3 grade dry peas, and $2.50 per cwt for sample grade dry peas. Producers of lower grade dry peas, who would have received a loan rate of $6.33 per cwt, instead received $5.83 per cwt for U.S. No. 2 grade dry peas, $5.33 per cwt for U.S. No. 3 grade dry peas, and $3.83 per cwt for sample grade dry peas. FSA also applied the discount to loan repayment rates. All grades for dry peas and lentils received the same LDP rates for their respective crops.[7] Because FSA applied the quality-based discounts, the loan repayment rate for dry peas remained above the congressionally set loan rate. As a result, producers did not receive LDP payments or marketing loan gains[8] on dry peas for crop year 2002.

However, displeased pulse crop industry officials contended to Congress that the discounted loan rates and the corresponding weekly repayment rates for pulse crops did not correspond to prices

---

[6] Public Law 104-127, April 4, 1996. The Secretary may make appropriate adjustment in the loan rates for any commodity for differences in grade, type, quality, location, and other factors.
[7] FSA News Release No. 0365.02, *USDA Announces 2002 Loan Rates for Lentils, Small Chickpeas, and Dry Peas*, dated September 3, 2002.
[8] A producer realizes a marketing loan gain if the loan is repaid at less than the loan principal. The marketing loan gain rate equals the amount by which the applicable loan rate exceeds the loan repayment rate.

for feed grade dry peas and U.S. No. 3 quality lentils as directed by the Joint Explanatory Statement accompanying the 2002 Farm Bill. In addition, they contended that by implementing the discounts USDA did not adhere to the Congressional intent of establishing MALs and LDPs for pulse crops. They also contended that the discount schedule lowered the producers' expected safety nets, which were intended to grow the pulse crop industry. Further, the North Dakota Department of Agriculture claimed that FSA's discount schedule caused pulse crop producers in the State to reconsider their planting decisions.

In response to the pulse crop industry concerns about FSA's discount schedule, Congress passed section 763 of the Consolidated Appropriations Resolution, Public Law 108 – 7, the 2003 Act, which (1) reversed USDA's administrative authority to discount the pulse crop loan rates for lower quality grades as it does for other commodities under the MAL program, (2) restated that the congressionally mandated loan rate for dry peas, lentils, and small chickpeas was based on U.S. feed quality dry peas, U.S. No. 3 grade for lentils, and chickpeas that drop below a 20/64 screen, and (3) based loan repayment rates for dry peas and lentils on the same quality grades established for the loan rates. In accordance with the 2003 Act, FSA announced revised 2003 loan rates for the three pulse crops. FSA also differentiated the 2003 loan rate for dry peas by region in accordance with the 2002 Farm Bill's Congressional Conferees' guidance.[9] On July 4, 2003, the PCP for dry peas was $8.00 per cwt. The following week, the first to reflect the changes mandated by the 2003 Act, the PCP dropped below the $6.33 per cwt loan rate to $4.00 per cwt. The 2003 Act enabled pulse crop producers to more predictably obtain MAL gains and LDPs than they could under FSA's discount schedule.[10] If FSA had continued to apply quality-based discounts, the loan repayment rate for dry peas would have remained above the congressionally set loan rate based on NASS and Agricultural Marketing Service reported prices for food peas during the 2003 crop year, and producers would not have received LDP payments or marketing loan gains until August 2004. As a result, FSA would have made no payments to dry pea producers for the 2003 crop year compared to the actual outlays of approximately $14 million.

Initially, implementation of the 2002 Farm Bill did not result in significantly increased production of pulse crops. However, we concluded that, since the 2003 Act, planted acres and production have increased. For example, according to a report issued by USDA's Economic Research Service (ERS), "[t]he presence of marketing loans in 2003 contributed to the expansion of dry pea acreage of one-third in North Dakota and one-fifth in Montana, above and beyond any increase due to market forces."[11] Other factors cited by ERS to account for the increase in planted acres and production included the lower costs of production for dry peas and the benefits of dry peas as a rotation crop. LDP payments issued, dollars loaned, and marketing loan gains

[9] FSA News Release No. 0075.03, February 25, 2003, stated that the Conference Report accompanying the 2002 Farm Bill suggested that USDA use the generally upward change in national loan rates to revise county loan rates. By doing so, USDA could eliminate disparities between loan rates and market prices that affected producer benefits. The Joint Explanatory Statement of the Committee of Conference, attached to House Conference Report 107-424, which accompanied the 2002 Farm Bill, specifically stated that the Managers intend that in determining loan repayment rates for loan commodities other than upland cotton and rice, the Secretary will consider alternative methodologies, including establishing the posted County prices for grains and oilseeds at levels that reflect market prices at both terminal markets for counties with two terminal markets. The Managers expect the Secretary to determine whether assigning equal weight to two terminal markets will better reflect local market prices than the current system of using the higher of the two terminal markets to establish the posted county price.

[10] To illustrate, there were no LDP rates for crop year 2002 when FSA's discount schedule was in effect. After FSA revised its process for setting loan rates to conform with the 2003 Act, the average weekly LDP for dry peas was $2.34 per cwt.

[11] "*Effects of Marketing Loans on U.S. Dry Peas and Lentils / Economic Research Report-58*," June 2008.

have increased for both dry peas and lentils compared to the 2002 crop year.[12] (See exhibit A.) A total of $126 million was estimated for the pulse crop loan program for crop year 2002 through 2006. As of May 2007 the total program cost totaled more than $139 million. (See exhibit B.)

FSA implemented the pulse crop program in the manner that Congress intended. The 2008 Farm Bill has since established lower marketing assistance loan rates for upcoming crop years. For example, the dry pea loan rate remained at $6.22 per cwt for crop year 2008, but decreased to $5.40 per cwt for crop years 2009 through 2012. Similarly, the loan rate for lentils remained at $11.72 per cwt for crop year 2008 but decreased to $11.28 per cwt for crop years 2009 through 2012.

We are not making any recommendation to FSA at this time. FSA subsequently indicated agreement with the conditions as presented in the draft report provided to them and advised us that an exit conference was not necessary. In addition, FSA declined the opportunity to provide a written response for inclusion in this report and no further response is required.

We appreciate the courtesies and cooperation extended to us by your staff.

[12] For the purposes of our review, we limited our review of pulse crops to dry peas and lentils and did not include chickpeas because of the limited MALs and LDPs for them.

Exhibit A – *Dry Pea and Lentil Analysis*

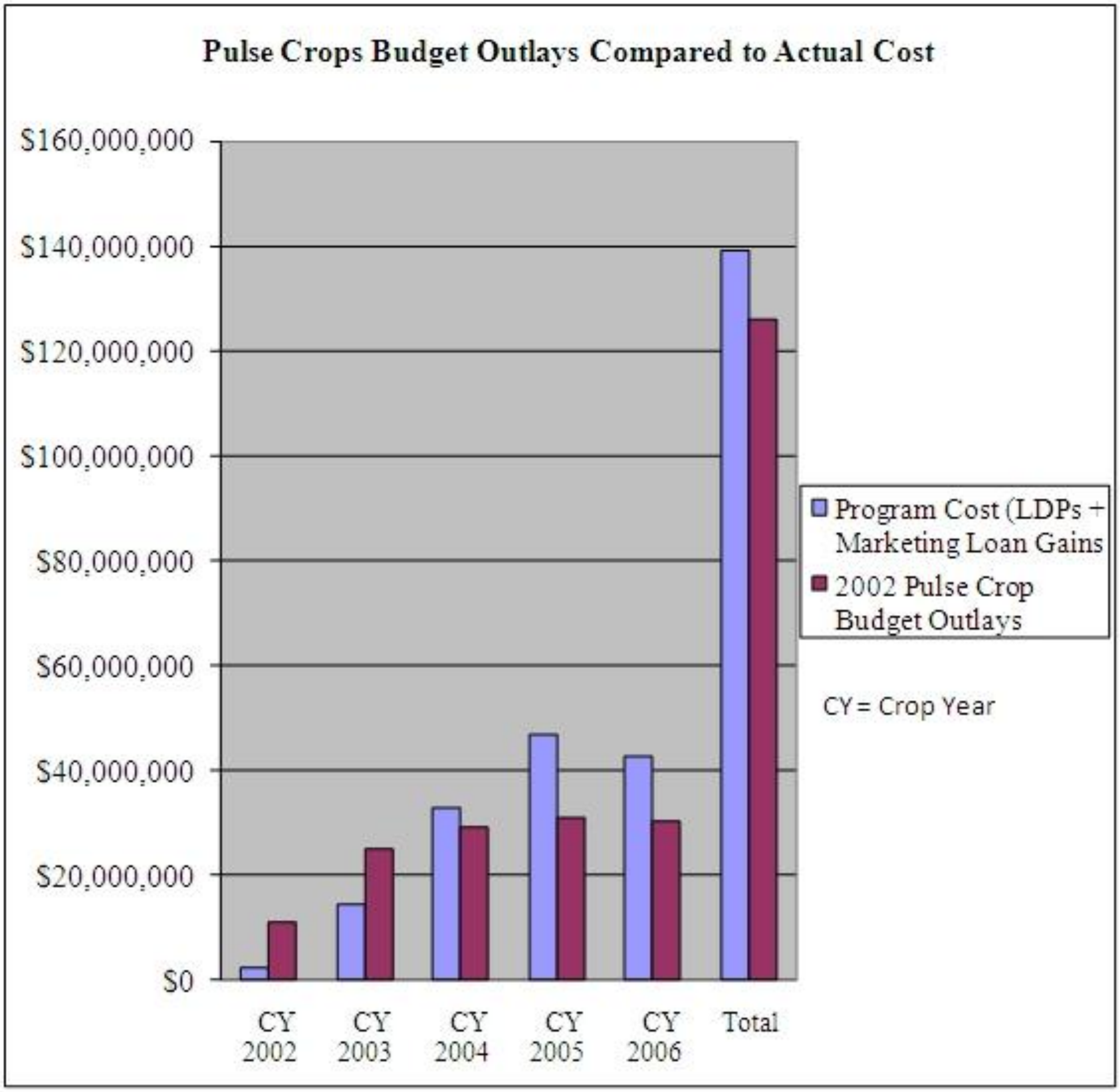
Dry Pea

Crop Year	Planted Acres	Production (CWT)	LDP Payments	Amount of Loans Made	Amount of Marketing Loan Gains
2002	308,700	4,727,000	$0	$1,099,628.61	$0
2003	337,500	5,202,000	$13,939,889.88	$607,637.95	$119,070.00
2004	530,000	11,419,000	$31,433,677.79	$1,725,821.99	$710,130.00
2005	808,000	14,003,000	$35,215,119.19	$5,580,869.61	$2,128,960.00
2006	925,500	13,203,000	$27,700.811.72	$4,588,238.46	$1,029,760.00
Total	2,909,700	48,554,000	$108,289,498.58	$13,602,196.62	$3,987,920.00

Lentil

Crop Year	Planted Acres	Production (CWT)	LDP Payments	Amount of Loans Made	Amount of Marketing Loan Gains
2002	226,000	2,571,000	$2,375,042.78	$357,060.41	$0
2003	246,000	2,442,000	$0	$2,063,587.48	$0
2004	345,000	4,182,000	$113,676.62	$9,500,515.37	$579,190.00
2005	450,000	5,163,000	$6,060,986.67	$15,528,284.03	$3,168,570.00
2006	429,000	3,244,000	$12,622,368.08	$5,483,869.60	$1,579,240.00
Total	1,696,000	17,602,000	$21,172,074.15	$32,933,316.89	$5,327,000.00

Exhibit B – Pulse Crop Budget Outlays Compared to Actual Cost



Informational copies of this report have been distributed to:

Administrator, FSA	
Attn: Agency Liaison Officer	(3)
Government Accountability Office	(1)
Office of Management and Budget	(1)
Office of the Chief Financial Officer	
Director, Planning and Accountability Division	(1)