

REVIEW TECHNICAL PROCEDURES OF USDA'S ESTABLISHMENT OF POSTED COUNTY PRICES

HEARING BEFORE THE SUBCOMMITTEE ON GENERAL FARM COMMODITIES AND RISK MANAGEMENT OF THE COMMITTEE ON AGRICULTURE HOUSE OF REPRESENTATIVES

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CONTENTS

	Page
Etheridge, Hon. Bob, a Representative in Congress from the State of North Carolina, opening statement	2
Moran, Hon. Jerry, a Representative in Congress from the State of Kansas, opening statement	1
Peterson, Hon. Collin C., a Representative in Congress from the State of Minnesota, opening statement	3

WITNESSES

Fletcher, John, general manager, Central Missouri AGRIService Inc., Marshall, MO, on behalf of the National Grain and Feed Association	25
Prepared statement	37
Gaibler, Floyd, Deputy Under Secretary, Farm and Foreign Agricultural Services, U.S. Department of Agriculture	4
Prepared statement	41
Answer to submitted question	69
O'Conner, Michael, member, National Farmers Union, Alcester, SD	26
Prepared statement	57
Reese, Sherman J., president, National Association of Wheat Growers, Echo, OR	20
Prepared statement	54
Shelor, Greg, vice president, legislation, National Grain Sorghum Producers, Minneola, KS	22
Prepared statement	60
Sonnenberg, Dean, president, National Sunflower Association, Fleming, CO ...	23
Prepared statement	36

SUBMITTED MATERIAL

Hayes, Evan, statement	71
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WEDNESDAY, DECEMBER 14, 2005

HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
SUBCOMMITTEE ON GENERAL FARM COMMODITIES
AND RISK MANAGEMENT,
Washington, DC.

The subcommittee met, pursuant to call, at 10:00 a.m., in room 1300 of the Longworth House Office Building, Hon. Jerry Moran (chairman of the subcommittee) presiding.

Members present: Representatives Lucas, Jenkins, Johnson, Bonner, Musgrave, Neugebauer, Conaway, Fortenberry, Goodlatte [ex officio], Osborne, Etheridge, Salazar, Barrow, Pomeroy, and Peterson [ex officio].

Staff present: Tyler Wegmeyer, Callista Gingrich, clerk; Bryan Dierlam, Lindsey Correa, Anne Simmons, and Clark Ogilvie.

OPENING STATEMENT OF HON. JERRY MORAN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF KANSAS

Mr. MORAN. Good morning. The hearing of this Subcommittee on General Farm Commodities and Risk Management will come to order.

We are here today to get a better understanding of how Department of Agriculture determines posted county prices and how accuracy throughout the system can be improved. This is a very technical subject; however, I think we will all benefit from a refresher course on how our loan program works and how posted county prices play an integral role in the structure of our farm programs. This will be especially important to our members as this subcommittee who will be instrumental in developing the next farm bill. We will be better equipped to address the needs of our producers if we have an in-depth understanding of the various elements of current farm law.

The 2002 farm bill provides our farmers with a three-part safety net comprised of direct payments, counter-cyclical payments, and marketing assistance loans. The marketing assistance loans provide farmers with short-term funds to meet expenses until their commodities are marketed. Loan deficiency payments are available if market prices dip below the loan rate or loan price, and producers can choose to forego the loan and opt for the LDP instead. These LDP payments are based upon local PCPs. The Farm Service

Agency uses PCPs to determine county loan level rates and Marketing Assistance Loan Program benefits for 17 different commodities. USDA monitors and sets over 88,000 posted county prices each day, 5 days a week.

The goal for the hearing today is to go beyond the superficial and to get a better understanding of the process and all of the factors involved in determining posted county prices. It has been brought to my attention by Kansas farmers that in the last couple of months, that in certain areas, PCP does not accurately reflect the local cash market price. In the instances they have pointed out, the PCP is considerably higher than the local price. At the same time, I understand there are instances in which the PCP would be lower than the local cash price. The question that probably should be addressed is not it is lower or higher, but whether or not the PCP accurately reflects the local market.

I thank Secretary Gaibler and Mr. Yost and Mr. Farrish from USDA for being responsive to the concerns that I have raised to the circumstances that Kansans have faced this year. The job of maintaining accuracy in the system is vitally important, not only for the integrity of the program, but also for the real effect it has on farmers' bottom lines. This year, farmers are facing the effects of higher input costs due to fuel and fertilizer cost inputs and various natural disasters, and I fear that any inaccuracy in PCP may exacerbate the strain on our farmers' pockets. Our Federal farm policies do not currently account for input costs that our producers are experiencing now, and I want to ensure that the programs we have in place to help our farmers do not inadvertently cause loss of revenue.

I look forward to hearing from our knowledgeable witnesses to get a fuller understanding of the current situation and where there may be opportunities for improvement, and I thank each of them for their appearance here today, and what I know is a significant effort to prepare for today's hearing.

I now recognize the gentleman from North Carolina, distinguished ranking member, Mr. Etheridge, for any opening remarks he may have.

OPENING STATEMENT OF HON. BOB ETHERIDGE, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NORTH CAROLINA

Mr. ETHERIDGE. Thank you, Mr. Chairman, and I appreciate your particular interest in examining the methodology of the USDA is using to establish posted county prices as part of the commodity Marketing Loan Assistance Program. I have been fortunate that I have not heard many complaints from my farmers about PCPs; however, no region of the Nation is immune from the potential problem of seeing PCPs fall dramatically out of line with local cash prices.

This hearing not only allows us to fulfill our oversight responsibilities to ensure the farm programs we enact are being implemented as we intended, but it also serves as a warm up for the farm bill hearings that we will be having later on, because I believe the Marketing Loan Assistance Program will be a popular topic in

future farm bill hearings, and I think these oversights are vitally important.

So I applaud your leadership in looking into this matter, and hope and trust that we will see more oversight hearings in the year to come. I served as chairman of the appropriations committee in the general assembly, and I can tell you, the oversight years were especially important to find out how things were working, whether they worked the way we wanted them to, and it helped keep the agencies in line with the legislative things we were doing.

And with your permission, Mr. Chairman, I would yield the balance of my time to the ranking member of the full committee, Mr. Peterson.

Mr. MORAN. The gentleman from Minnesota is recognized.

OPENING STATEMENT OF HON. COLLIN C. PETERSON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MINNESOTA

Mr. PETERSON. Thank you, Mr. Chairman, and I thank the ranking member for yielding.

This is an interesting time to have this hearing, given everything that is going on around us. Our trade negotiators are in Hong Kong and have offered up some substantial reductions in our farm programs over there. I am not sure it is going any place, but it is out there. We have those here in the country who want to dismantle commodity programs as we know them, and they are continuing their public relation campaigns here at home.

With that said, it will be at least two more crop years before producers could feel the impact of any major changes that may come about because of the Doha trade agreement, further budget cuts for the next farm bill. And this means that we will need to be sure that our current programs are serving producers well until then.

I am interested to hear from the Farm Service Agency about their day-to-day operation of the Marketing Loan Assistance Program, and particularly LDPs. I have counties in my district who are wondering why their neighboring counties in Minnesota saw their terminal changed, when they don't feel that their grain flows to the Pacific Northwest either. I also look forward to hearing from the producers joining us here today about what can be done in the short term to make sure that the program is working as well as any long-term thinking they have been doing about the next farm bill.

Mr. Chairman, I thank you for calling this hearing. I am looking forward to hearing from the witnesses.

Mr. MORAN. Mr. Peterson, thank you for joining us today. The chair now recognizes Mr. Floyd Gaibler, the Deputy Under Secretary for Farm and Foreign Agricultural Services at the U.S. Department of Agriculture. He is accompanied, no, I will let you introduce the folks you are accompanied by, Mr. Gaibler. Thank you very much for joining us.

STATEMENT OF FLOYD GAIBLER, DEPUTY UNDER SECRETARY, FARM AND FOREIGN AGRICULTURAL SERVICES, USDA, ACCOMPANIED BY MIKE YOST, ASSOCIATE ADMINISTRATOR FOR PROGRAMS, USDA, AND BERT FARRISH, DEPUTY ADMINISTRATOR FOR COMMODITY OPERATIONS, USDA

Mr. GAIBLER. Thank you, Mr. Chairman and members of the subcommittee. I appreciate the opportunity come before you today to discuss posted county prices. Joining me today is Mike Yost, Farm Service Agency Associate Administrator for Programs, and Bert Farrish, who is the Deputy Administrator for Commodity Operations.

This subcommittee has asked the Department to assess the technical procedures of USDA's establishment of the PCP Program system, and explain the Department's plan to continue to improve the accuracy of this system.

The PCP is a proxy for the cash value of a commodity. It is determined by taking terminal prices, then subtracting a value reflecting historical relationships between local and terminal market prices, and then adding or subtracting a value to minimize differences across State and county boundaries, and reflect localized, current year market anomalies. When terminal markets and county prices vary significantly because of differing supply and demand factors, the resulting demand can be a variance in PCPs and marketing assistance loan benefits between neighboring counties.

Concerns over USDA's PCP system occur when program benefits differ widely in adjacent or neighboring counties, or when PCPs exceed cash market prices, or when the cash, local cash price plus LDP is below the loan rate. Counties that are adjacent to those different terminal markets, or counties where the two terminal markets used to calculate the PCPs are different, are more likely to reflect discernable differences.

Utilizing the loan provision is the only way for the producer to guarantee receipt of the loan rate for the applicable crop. The national loan rate for each commodity is set by statute. Loan rates for each county are determined once per year, and all county loan rates for a particular commodity must balance back to the statutory national rate. Once a loan rate is set for a year, it does not change. The loan rates are then updated each year to reflect PCPs, production and adjustments to differentials.

The challenge is establishing PCPs reflective of local cash prices while minimizing resulting discrepancies in marketing loan benefits. If PCPs in each county are reflective of local cash prices, differences in marketing loan benefits may naturally widen between State and county boundaries, contrary to statutory provisions. Conversely, if PCPs are established to ensure that differences in marketing loan benefits are held to a minimum, PCPs will not reflect local cash prices. When PCPs are adjusted accurately to reflect local cash prices, but the adjustments are limited geographically, then marketing loan benefit rift lines occur.

The emphasis on the statutory requirement to minimize marketing assistance loan benefits across State and county boundaries has created equal benefits within specific geopolitical boundaries, such as within a State. With a dynamic marketplace overlaying the static values, inaccuracies in the PCPs occur.

Another challenge occurs from using PCPs to determine county loan rates for subsequent crop years. Loan rates are established for each commodity and county on an annual basis; and conversely, market prices fluctuate on a daily basis to reflect local market conditions. Adjustments to lower PCPs in order to gain marketing benefits will result in lowering the county loan rate in subsequent crop years.

Unlike previous years, 2005 has affected PCPs with four separate key situations: one, some of the typical advantages of barge rates over rail rates eroded late last summer because of low water levels in the upper Mississippi River caused by the draught in Corn Belt States; two, in the Mississippi and Texas Gulf regions, the 1–2 punch of Hurricane Katrina followed by Rita affected both rail and water transportation negatively; three, energy and fertilizer prices soared in the past year along with crude oil prices and natural gas prices; and four, significantly higher 2005 crop years, coupled with carryovers from record 2004 crops, contributed to lower export demands.

The FSA has initiated a review of the current policies and processes that compose the PCP system. This review will examine the basic assumptions regarding equal marketing assistance loan benefits and LDPs within a specific geographic or geopolitical area, and the commonly held belief that LDP plus the local cash price should equal the county loan rate. Further emerging market dynamics like ethanol, fuel costs, and rail and barge capacity must be reexamined. In both 2004 and 2005, as part of the county loan rate review, all county differentials were adjusted to reflect ethanol plant locations and market influences. All aspects of price discovery, including collection and reporting processes, will be studied. And the FSA intends to complete this review before the start of the 2006 marketing year.

In conclusion, we believe we are meeting the legislative objectives of the Marketing Assistance Loan Program. Are there efforts without flaws? No. But flaws usually surface when outside influences affect farming, such as natural disasters and high energy prices. The two most recently extraordinarily large crops have had a significant impact in administering the PCP system. We are aware of these risks and know how to make quick and successful judgments, and we will continue to work to improve the process. Thank you, Mr. Chairman.

[The prepared statement of Mr. Gaibler appears at the conclusion of the hearing.]

Mr. MORAN. Thank you, Mr. Secretary. Mr. Secretary, I have a number of questions, all of which I struggled to understand even the question, let alone, I guess, your answer. But walk me through if you would, please, tomorrow, Thursday in Kansas, in Republic County, KS, there will be a posted county price at the local USDA office. What happens at the USDA here in Washington, DC and what happens in Republic County, KS to establish what those numbers are this week in a county in Kansas?

Mr. GAIBLER. If I might, Mr. Chairman, I would defer to Mr. Farrish, since his division handles that process.

Mr. MORAN. Thank you, Mr. Secretary. Mr. Farrish.

Mr. FARRISH. Thank you, Mr. Chairman. Each day, when the markets close, we look at the market closes in each particular crop, and then we have a formula or a process that we go through to establish the posted county price.

Mr. MORAN. We being somebody here at the USDA in Washington, DC?

Mr. FARRISH. Well, it is primarily our staff in Kansas City.

Mr. MORAN. OK.

Mr. FARRISH. We oversee that staff from here in Washington and talk to them each during that process. But if you would like for me to walk you through the formula, I can certainly do that.

Mr. MORAN. Please.

Mr. FARRISH. We have got the country divided up into a number of terminal marketing areas, or terminal markets, if you will. We establish what that price would be in that terminal market, whether that be the Gulf, whether it be Decatur, IL, and I am using corn as an example today, Kansas City, Minnesota, Pacific Northwest, which is an export market, we will establish what that terminal market price is each day. And then we have a couple of adjustments we use to get down to the county price. One of those adjustments is the county differential that has been established over the past year, and we review those differentials once a year. So we will take the terminal market price, we either add or subtract that county differential, and then we have a terminal adjustment that we use, and we will either add or subtract that to get down to what is our posted county price.

And then we also do telephone work each day. We make about 500 calls per day to all the grain production areas to double-check prices, especially into areas where we may sense that we have a problem or have a problem reported to us. We look at DTN information. We look at information on terminal prices from AMS, the Agricultural Marketing Service, to compare those and see if we are in line. But basically that is the process. It is a calculation process, not a matter of calling a location and saying we are going to use the price in this location as the posted county price today. These differentials have been established over long periods of time, and they represent historical trading and value relationships between that county and the markets that service it.

Now, we do try to establish two terminal markets for each area, and then we will take those, we will calculate them both, and we will use the higher value as the posted county price, using the theory that the producer would always sell his grain the higher market and not the lower market.

Mr. MORAN. When you say two areas, how do you define an area?

Mr. FARRISH. Two terminal market areas. OK. For instance, we may, in the State of Illinois, we will look at the Gulf and the Decatur market. In the State of Minnesota, we will look at the Pacific Northwest and the Minnesota market, except in the southeastern corner of Minnesota. Today, we are using the Gulf market and the Minnesota market and comparing those two. In the State of Kansas, we would use the Gulf market and the Kansas City market to compare and then choose the higher of the two to be the posted county price.

Mr. MORAN. The explanation, then, for why there would be a difference from one county to an adjoining county, or across the State line, well, I have chose Republic County, Kansas. It sits on the Nebraska border. I don't know what the adjoining county is to the north of Republic County in Nebraska. But as you know, often the conversation that you get, that we get, is across the county line or across the State line, it is a different posted county price. And the explanation for that would be the county differential, based upon this historic pattern? And also, I suppose, what market you are looking at, based upon the geography.

Mr. FARRISH. That would be correct. More often the question is why there is a difference in LDP values across State and county lines, not necessarily posted county price. Or quite often the question is why is there a difference between cash values and posted county price values. Those differences can occur for a number of marketing reasons, weather reasons, transportation reasons, and it is very difficult to adjust those down every day in every county, because we tend to look at long periods of time and not one day at a time.

Mr. MORAN. What process do you have in place to correct errors?

Mr. FARRISH. We can review, if we see where we think there is an error or a marketing anomaly, if you will, or a value anomaly in an area, we can adjust, we can make temporary adjustments to the county differentials. We have made State-only adjustments occasionally to reflect a change, maybe, in marketing patters or transportation patterns within that State. And then, if that situation reverses itself, then we return to the original values that we were using.

Mr. MORAN. Mr. Farrish, thank you. Let me recognize the gentleman from North Carolina, Mr. Etheridge.

Mr. ETHERIDGE. Thank you, Mr. Chairman.

I want to focus first on the USDA's upcoming review of the PCP process mentioned in your testimony. You all intend to complete it, you said, before the start of the 2006 marketing year. My question is, will they contain recommended changes and adjustments in the process? And if so, will such changes be in place before the new marketing year, or will there be any public review or a comment period?

Mr. GAIBLER. Well, we certainly intend to have the changes in place before the implementation of the marketing year. And I think we would encourage input from commodity and farm groups and this committee as we work through that process. We may even consider utilizing a third party to evaluate the process and provide us some recommendations along those lines. We will certainly work with the committee and the affected commodity groups as we proceed through this review.

Mr. ETHERIDGE. Let me follow that up, because you said you may consider. Would you be willing to go a little bit farther and say you will do it or you are going to do? Or is that going to pattern any history, or how has it been done?

Mr. GAIBLER. We are always welcome to try and maintain a dialog with the industry. I continually have to do this with price discovery problems with the Peanut Program, for example. And so we

have always had a tradition of being open and having a dialog and we will do that.

Mr. ETHERIDGE. I would encourage that because I think that is healthy. I think, No. 1, it gives more credibility and less friction later one with the people who are affected. The National Sorghum Producers will testify in the next panel, and they are going to testify that their growers need small regions in determining LDPs. As you will be aware of the testimony when it comes up, I will ask you to respond to their request now, because certainly you may not be here when they testify. And in the process, talk about how these regions are established and the tradeoffs for having larger or smaller or fewer or more regions, because I think that is their concern. Sometimes the smaller folks get caught in the gap when you look at broader pieces. And if you would share that thinking with us, I think that would be helpful to these producers.

Mr. YOST. Thank you, Mr. Chairman. Mr. Gaibler has asked me to tackle that question for you.

There are benefits and maybe pluses and minuses to having larger areas and smaller areas. In 2001 the system was reviewed in terminal marketing areas where a real—

Mr. ETHERIDGE. I don't want to interrupt you, but are you going to share with us what those pluses and minuses are?

Mr. YOST. Yes, I will get to that.

Mr. ETHERIDGE. OK, thank you.

Mr. YOST. In 2001, in all our crops, those terminal marketing areas were looked at. The focus coming into 2001 had been to provide level LDP, or marketing loan gains in LDP benefits across broad regions of the country. So in 2001 the number of terminal marketing areas were reduced, specifically, I am not sure in sorghum and I don't have that exact number with me, but in general, all crops received a reduction in terminal marketing areas. Specifically, in corn, we went from 16 to 10. Some of those markets were irrelevant as far as broad trading of corn, and the same thing in sorghum and wheat and other crops, because of changing marketing patterns. So historically the focus had been on changing or providing level benefits across broad areas. Coming into this review that we are talking about, certainly that will be one of the areas that we look again; are these terminal market areas reflective of the market today?

I understand their concern. One of the minuses may be, perhaps to some folks, in going to more marketing areas. That draws up more divisions in the country, which provides the opportunity or the chance that there will be more differences across various lines in the country, which has been opposed in the past by some groups and some individuals involved in the process who continue to want level benefits across broad areas.

While we have provided a level LDP across a broad area, in some cases, it has thrown the PCP versus cash values off. Can that be tackled with smaller areas? Perhaps. But again, the price of that would be, or the result of that would be, would be bigger differences across those marketing lines to do that.

Mr. ETHERIDGE. Mr. Chairman, I see that my time has expired. But it seems to me that this is one of those areas where the challenge is, and I think this is part of the reason we are here, and

I would encourage you to take a hard look at that. Thank you, Mr. Chairman. I yield back.

Mr. MORAN. Thank you, Mr. Etheridge. The chair recognizes the distinguished gentleman from Virginia, the chairman of the committee, for any opening statement or questions of the witnesses. Welcome, Mr. Chairman.

The CHAIRMAN. Thank you, Mr. Chairman. I appreciate you very much holding this hearing to discuss the USDA's procedures for determining county, posted county prices for farm bill commodity programs.

I am here to learn about this subject. It seems to me that to administer the Marketing Loan Program, loan deficiency payments, and marketing loan gains, the USDA must calculate nearly 88,000 posted county prices each day. This is obviously a large task, given the resources with which the USDA has to work. And that task is even more complicated, given that the markets for these commodities are dynamic and are changing all day, every day.

Administering daily fixed posted county prices within this dynamic market could lead to market distortions. So I want to understand the mechanics of how the USDA determines the posted county prices each day, the steps they take to minimize distortions within the loan program, and the areas where the USDA could improve the process to further minimize future distortions. Congress have given the USDA many parameters in which to operate the loan program, and I want to ensure that the USDA is operating within those parameters in a way that minimizes unintended consequences to the program.

I don't have any questions at this time, but I do thank you for recognizing me, and I look forward to hearing the answers to the other Members' questions.

Mr. MORAN. Thank you, Mr. Chairman, very much for joining us. The gentleman from Colorado, Mr. Salazar.

Mr. SALAZAR. Thank you, Mr. Chairman.

Back in the early 1980's when I was a young, struggling, beginning farmer, I worked for the USDA, back then known as the ASCS office. I guess now it is known as the FSA office. And as we struggled to figure out how we could help farmers in the area, one of my biggest problems and one of my biggest concerns, of course, was how USDA and their price setting or their actual loan setting price was really affecting or was it really doing or affecting the market in an artificial way? Because the market never did change much from what the loan price was set at, up or down a few cents. And could you comment a little bit about what your sense is of when you set the price early on in the year, does it affect the market down a little bit later in the year, if you would, Mr. Under Secretary?

Mr. GAIBLER. The first response that I would give you is that there has been a lot of change in the market dynamics since the 1980's. We have seen a lot of shift in production and marketing patterns. We have seen the emergence of ethanol into the industry, and that has created more price and market volatility, and we anticipate that that market volatility will continue to grow and not lessen in the future. With that in mind, it is imperative for us to try and improve this program that we have as much as possible so

that we can reflect those changes in the marketing place, and then try and do it in a way that won't try and manipulate or have an adverse impact on prices. This market loan program is simply trying to provide a market-clearing mechanism. And so what we need to do is make sure we have as much timely and accurate information as possible so that that program can work efficiently. But it is going to be more of a challenge, as I mentioned, because there will be more volatility in the market than there was 20 years ago.

Mr. SALAZAR. One of the things that I guess still sticks in my mind is, several years ago, someone mentioned here about the drought that we suffered. It was a severe draught throughout the entire western States that we know of, and the wheat prices and the wheat stocks, the reserves were way down. Yet wheat prices didn't really move upward in any way, shape, or form, and they hovered right around, I believe, the county loan rates, which were, I believe, at that time \$2.20 or \$2.70 for wheat. I can't remember exactly. Well, \$2.75 I think. And so with there being such a shortage in the United States, it seems like the market, of course, it is about holding market volatility and keeping it to a constant point. But I think it adversely affects many ag producers, and maybe I do believe that it probably does establish some kind of a price setting for commodity marketers or traders. So that was my concern.

Mr. GAIBLER. Well again, the level of the loan rate is going to establish a price floor, so that will always have some impact on what prices will be. But ultimately the market is going to allocate supply and demand. And so in the case of wheat, we have not seen a lot of change and production yields have been very flat for the most part, and it is not had a dynamic market as to, say, the soybean or the corn market.

Mr. SALAZAR. And, Mr. Farrish, can you expound a little bit about how the county differential is actually set? For example, I live in the valley, called the San Luis Valley, which is basically one market region throughout the area, although I guess some areas are considered to be in different terminal markets, and there are six continuous counties, contiguous counties in the San Luis Valley. But could you expound a little bit about how the county differential is established?

Mr. FARRISH. Well, the county differentials have been around for a very long time, and maybe we should go back in history a little ways. Originally, this system began in about 1985 and it was a posted elevator price back then to value PIK certificates, when we have the PIK Program, to dispose of large inventories of CCC grain. It has developed over time and came into use to develop, or to value all CCC inventories, and it was continually refined to use it as part of the LDP to determine posted county prices. As I have said, the county differential is a part of that. That differential has been maintained and adjusted over long periods of time to reflect the value of that grain, whether it is wheat or corn or sorghum, in that county, value it in traditional marketing patterns. We review those county differentials each year as a part of formulating new loan rates each year. And we go back and look at prices and history and where grain is being marketed, and make a determination as to whether that needs to be adjusted or not to accurately reflect that value relationship in the marketplace for that county.

Mr. SALAZAR. Thank you, Mr. Chairman.

Mr. MORAN. Thank you, Mr. Salazar. The chair recognizes the gentlewoman from Colorado, Mrs. Musgrave.

Mrs. MUSGRAVE. Thank you, Mr. Chairman.

Lots of times we have constituents call us and they have called the USDA and they have concerns. And I just wondered if there is some assurances you can give us. I don't like to call your office. I don't like to have my staff give you a call and pass those things on. I like to be able to tell my constituents that you are addressing it, and I believe that you are making efforts to do that. Could you just give us some information on how you are addressing the concerns when you get these calls from people that are extremely frustrated?

Mr. GAIBLER. Well, in general, when we do get inquiries, either directly from producers or through our State and local county offices, we immediately go out and look at the situation and try and verify what the prices are and determine if they are out of line. And if they are, we will make adjustments. We try to be proactive. We can't obviously spot all of these anomalies on our own.

Mrs. MUSGRAVE. Yes.

Mr. GAIBLER. But when they are brought before us, we will certainly address them and have addressed them. Sometimes they will come directly to you as a member. I will respond as well. But we would encourage producers, whenever they notice these concerns, to come to us directly and we can respond as quickly then as possible.

Mrs. MUSGRAVE. Could you give me kind of a cheat sheet for my agriculture legislative assistant, so when we get these calls, you can say, when you see what you think is an anomaly, this is what is going to happen? And like, do those people actually get a call back after they have pointed something out that they think is glaring?

Mr. GAIBLER. I will let Bert. Mr. Farrish deals with this directly.

Mr. FARRISH. OK. Well, thank you, Congresswoman. We get input from a lot of different sources. We get input from producers directly from their commodity groups, from congressional offices, and quite often from our own State and county offices, give us input into problems that they foresee out there. I think it is very important for us to remember that we have what is called a posted county price, not the local price. And as you can see in our written testimony, you can have areas or counties in the country with widely different values within that county for the same crop. I think we point out some instances where, in the same town, corn and soybeans were valued 9 cents a bushel differently in two locations in the same town.

So the question becomes, what is the true county price? What is the true price in the county? And that is a challenge as we go out and verify these problems and try to examine what is causing it. Because quite often we find situations where a company perhaps is out of the market and not interested in buying grain and they drop their price quite a ways, which causes us to be above it. The expectation is that they will be back in the market in a few days and that price could rise again. So it makes it a challenge, poses a challenge for us to whether we make a change in the differentials

for an isolated situation like that. And then it has an impact on the rest of the county and the counties around it. Because the first question I am going to ask our staff is, what is the unintended consequence of doing this, because usually there can be one.

Mrs. MUSGRAVE. Yes.

Mr. FARRISH. But we do have a process and quite often they will bring those problems all the way up to my level. And we conference called here in Washington with our staff in Kansas City to try to resolve the problem.

Mrs. MUSGRAVE. What is the time turnaround?

Mr. FARRISH. It is usually fairly fast. If we are made aware of an issue, if we are made aware here in Washington of an issue with a price in a county somewhere, we will immediately call our folks in Kansas City and say, you need to get on the phone this afternoon and take a look at this. Sometimes calls come in directly into the Kansas City staff, and we may or may not find out about it here in Washington, but we find out about most of them. A lot of times they are resolved locally in Kansas City, but it is usually a fairly fast turnaround to take a look at it. That doesn't mean that we are going to necessarily make a change, but we can explain it and understand it.

Mrs. MUSGRAVE. I understand that. And what we need to be able to tell our constituents is how you react, how quickly you react and how serious you take their concerns.

Mr. FARRISH. Yes. OK, thank you. We take all their concerns very seriously and we will react and turn it around within a day.

Mrs. MUSGRAVE. Thank you.

Mr. GAIBLER. We would be happy, Congresswoman, to provide you sort of an outline of the process that we go through so that you can understand the steps.

Mrs. MUSGRAVE. I would appreciate that. Thank you. Thank you, Mr. Chairman.

Mr. MORAN. You are welcome. The gentleman from Minnesota, Mr. Peterson.

Mr. PETERSON. Thank you, Mr. Chairman. And I hope I can get through this in 5 minutes, but if you would indulge me, because we have a situation here that if we can work through this, I think it would be helpful to the committee to understand some of the ramifications.

Mr. MORAN. We will see how it goes, Mr. Peterson.

Mr. PETERSON. Back in, I think, October 27, they reclassified 13 counties in the southeast part of Minnesota. They made the case that they had a problem between the cash and the posted county price because of the river being shut down. The farmers over further west, I think were basically in the same situation. But now they are in the Pacific Northwest market and the other 13 counties are in the Gulf market, and I don't think there is much evidence that the corn goes west, but that would be one question.

I have got some charts here that you made up. Prior to this, the price down in the southeast was a lot less. It was \$1.22 versus \$1.49, \$1.47. But I think there is other factors that could be involved here. It could be that there is more livestock, more ethanol use up in that area that affects this. It could be that the farmers store their grain in hope of making some money and got caught,

and the government's bailing them out. There is a lot of other issues that can get involved in all of this, and I am not sure. Well, it is not transparent to me that all of that was taken into consideration.

And then, if you look at soybeans, you got the same kind of deal, but nothing was done there, apparently, because they were, the LDPs weren't triggered, I guess, so you left that alone. But so, I guess, number one, what evidence do you have that these counties that were not in that area, that that grain is actually going west, because they are telling me it doesn't. Another question I have is, aren't you going to just have people that are LDP shopping going into those 13 counties so they can get a better deal? And another question is, as I understand it, that posted county prices are established, they are used to figure out the loan rates, and so could not the effect of this be that a year from now or 2 years from now, that area is going to actually end up with a lower loan rate because of what you did? Or is this because it was temporary? It is just not going to be the case. And last, how is the ethanol market factoring into this thing, because we have a lot of ethanol plants in this area that has these higher prices. I guess there are just a lot of questions out in my area about what happened here, and I am not sure you didn't cause more problems than you are solving in the long term. I know that is a lot of questions.

Mr. GAIBLER. I will let Mr. Farrish, because he has been working on this issue specifically.

Mr. FARRISH. Well, thank you for that opportunity.

Mr. PETERSON. Do you recognize your charts?

Mr. FARRISH. Yes, sir, I do.

Mr. PETERSON. OK.

Mr. FARRISH. And we produce those each day. You are correct. We did make a temporary change in southeast Minnesota. I think, as you know, I was asked by John Muncin, our state executive director, to come out to Minnesota in October and meet with producers and others in that area to discuss the situation in southeast Minnesota. But let me, I guess, put in perspective of the type of year that we had. We had an extremely difficult situation in freight. Freight values along that section of the Mississippi River were at historic highs. I find southeast Minnesota to be an area that is a storage deficit area, meaning, there is not enough storage to handle the crop and the normal movement. And because of the size of the crop, it put a lot of pressure on the system there.

Mr. PETERSON. And that didn't happen in those other counties?

Mr. FARRISH. Well, yes. No, I am not saying—

Mr. PETERSON. Because every town in the other areas got corn out of the ground right now.

Mr. FARRISH. Yes. And I understand that. But southeast Minnesota is an area that the corn does not generally move to the west. It moves to the Gulf along the river. That is the traditional marketing pattern.

So I sat down with our State executive director in working with the producers in that area. And I give a lot of credit to John Muncin. He is the one, with our assistance, who worked out the 13 counties that he felt should be set aside and worked off the Gulf market and not the PNW and the Minnesota market. So now we

use the Gulf and Minnesota market to value, as terminal marketing areas, to value corn in that region. We do find that corn, as you move west, it moves more to the ethanol industry. It moves westward to the Pacific Northwest for export as opposed to moving east.

You are correct about chasing LDPs, if you will, because that is one of the unintended consequences that we try hard to watch for and not create. We could have made posted county prices right on the money along the river in that area, but it would have created huge LD fees and caused producers from all over to want to drive to that area and market their corn in an area that had no transportation and no storage. So we don't want to encourage movement into an area that doesn't want the product.

The ethanol factor, you asked about that. It is a big factor. We have been taking that into account each year by adjusting differentials in those counties to try to more accurately reflect what ethanol values, or the value that ethanol is creating in those counties for corn.

Mr. PETERSON. But just one clarification. What evidence do you have that that grain is moving west for export?

Mr. FARRISH. Out of central Minnesota?

Mr. PETERSON. Yes. Well, like out of Big Stone County or Stevens County. They don't think it is.

Mr. GAIBLER. We will let Mr. Yost, who is a resident of Minnesota.

Mr. FARRISH. He is a Minnesota farmer.

Mr. YOST. Well, Congressman, as you stated, there is a significant expansion of the ethanol industry out there. There is. There are two train loaders in my home county, in Swift County, and they are loading corn to go out to the west coast, periodically during harvests and periods of high movement in the summertime. So part of the year they are. And of course it depends on the size of the crop, coupled with the increase in demand for ethanol. We also had a huge crop out there this year, as you well know, 200 bushels of corn. So it is just that we are ratcheting things up. So I personally believe that we will always have a market for ethanol, or corn for ethanol out there, very significant, and it will take precedent some of time, and I also think the Pacific Northwest market will also come into play because of the infrastructure already in place. There are several hundred 10-car train loaders out there. So I believe there is some evidence, but you are correct in saying that it is less than it used to be. You are very correct. So I think both markets are legitimate.

Mr. PETERSON. And is this temporary thing going to affect their loan rates or not?

Mr. FARRISH. Well, I want an opportunity to address that, too. I forgot to when I was speaking previously. Yes, it can and that is one of the things we were very clear to producers, and we are always very clear to producers when they come in and ask us to lower their PCPs or change the county differential to give them a lower PCP. We are very clear with them that this could have a negative effect on your loan rate in the coming year, and we have always had that discussion with them.

And just to follow up on what Mr. Yost had to say. One of the things that I do on a daily basis is follow the vessel lineups around

the country, and I look at the Pacific Northwest every day to see what products are being loaded out there for export. And there is significant corn movement, has been significant corn movement out of the Pacific Northwest all during harvest, and that continues today. As well as soybeans. And all of that corn and soybeans has to come from the western production belt, which means central Minnesota and westward.

Mr. PETERSON. Thank you, Mr. Chairman.

Mr. MORAN. Thank you, Mr. Peterson. The gentleman from Texas.

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

One of the concerns, I have a lot of sorghum producers in my district, and one of their concerns is that the posted county prices have not really been reflective of the county price to the cash price in the area, and that the producers are concerned that the efforts to kind of minimize these differences between the LDPs and the marketing loan benefits across the county and State borders have kind of led USDA to adjust the posted county prices to the point where they are not reflective, that more of trying to manage the loan deficiency process than really trying to make the posted county prices reflective of the county prices. I think, in the previous farm program, I think the loan deficiency payments were more county determined rather than regionally determined. And now, moving to more of these regional pricings and regional determinations for loan deficiency prices, again are causing producers to make decisions based on loan deficiency payments and not based on what the cash price for those commodities are.

So that kind of leads me to three questions. And, Mr. Secretary, you can kind of fan those out as you see fit. But one is, what are you finding, for example, in grain sorghum, why there are quite a bit of difference between the posted county prices and cash prices? When you looked into that, what did you find? And second, is there a better way to come up with a posted county price and local cash prices in these loan deficiencies that is more reflective of those specific areas, and not having the producers looking at loan deficiency prices or loan deficiency payments that in some cases would be less beneficial to them than really what is going on in the cash market in that particular area? And what kind of responses has USDA initiated when the grain sorghum folks have brought this to you?

Mr. GAIBLER. Well, we did have some occurrences here in October and November with grain sorghum producers. In October, there was a concern about the inequity between the LDP rates for grain sorghum and then the corn LDP rates. And so we did look into that. And at the time, the research did disclose that the grain sorghum PCPs were, on average, reflective of the local cash prices. But then, later on, there was the concern about where the PCPs actually exceeded the local cash price. And there were some scattered counties in problem areas and there were some changes made there. I think part of the problem is that equating the corn to the grain sorghum is a difficult one. Those are two entirely different markets. You have a very large corn market of 11 million bushels being grown. It is much more geographically spread. There are wider markets and market dynamics in play. And the grain sorghum is a more thinly traded, more locally regional type of com-

modity. And it may be there are ways that we need to look at grain sorghum in particular, in terms of looking at it on a county versus some sort of a regional basis. I know that Mike and Bert have already had conversations with the grain sorghum folks, and it is something that we will continue to talk about with them.

Mr. NEUGEBAUER. And I would look forward to being a part of those discussions, Mr. Secretary. Maybe we could bring some of the sorghum people in and look at that, because I think, certainly, we don't want to have a policy in there that is shifting planning decisions based on our policy. It needs to be based on the market conditions. And I would look forward to entering into some dialog with you about that. And hopefully, and I think this administration has been receptive to sitting down with commodity groups when they have specific issues, and I would hope that invitation would be open to our friends in sorghum.

Mr. GAIBLER. Yes, we certainly will. We will be pleased to involve you. And again, as I mentioned earlier, we think it is important to have a dialog, and as we go through this review, it will be critical to have their input and yours as well.

Mr. NEUGEBAUER. Thank you, Secretary.

Mr. MORAN. Thank you, Mr. Neugebauer. I would ask unanimous consent of the committee that we allow the gentleman from Nebraska to join us at the dais, and that he be allowed to ask questions of the witnesses and make any statement he would like to make. No objection. Mr. Osborne is recognized.

Mr. OSBORNE. I thank the chairman for his forbearance in letting me appear in his committee. I appreciate it. And I would like to pursue Mr. Neugebauer's question a little further.

As you probably know, sorghum uses about 25 percent of the amount of water that corn does; about 25 percent less input cost. And the loan rates were equalized for corn and sorghum in the 2002 farm bill. And yet, as Mr. Neugebauer indicated, it does seem that our policies do in many cases tend to shift planning from sorghum into corn. We have seen that steadily and yet, in the Midwest and particularly in Mr. Moran's case and my case, we are really seeing some problems with water issues. Sorghum is something that would be very, very helpful, to have more acres planted in sorghum. So rather than having a large regional LDP system, it would appear that maybe we need to break this up, whether it be county or whatever, because right now there seems to be some inequities.

And I know you have commented on this previously, but do you have any thoughts? Because I believe the region right now includes Kansas, Texas, Nebraska, Colorado, Oklahoma, Missouri, Illinois, and South Dakota. And so what we are doing is we are adjusting the posted county prices in every county to match the loan rate. But that is a huge area, and I think maybe this is causing some distortion and some problems. And you mentioned that you might be looking at doing something different here. But could you flesh that out a little bit as to whether you would want to break that region up a little bit, or would you want to go to a county approach? Or how would you do this?

Mr. GAIBLER. Well, I will let either of these, because they have already had some preliminary discussions about that.

Mr. YOST. Congressman, we have talked with the grain sorghum folks about this. We recognize the problem. We recognize the need to change. Sorghum is not unique. There is other commodities that have similar circumstances. There is some overriding issues with the grain sorghum industry that was beyond our control. The marketplace is different between corn and grain sorghum. There is different prices. Corn has had a lot of biotech advancements in it that has enhanced production of it. We can't affect that. But nonetheless, we talk to grain sorghum folks. We know they have some valid concerns. They talked about new ethanol plants going up, a 20 to 30 million bushel increase in demand in a crop that is probably under 400 million bushels. Definitely it is going to affect the marketplace and how we are going to establish posted county prices. So we look forward to working with them in the future, and your staff.

Mr. OSBORNE. OK. I have one further question and that is, right now we have got a lot of grain on the ground. We have high ending stocks at the of last year and another heavy production year. Does USDA many provisions or if you have got anything in mind as to how to provide more storage? Because it is really becoming worrisome, I think, for lots of people.

Mr. YOST. Well, as we noted in our testimony, that is a concern of ours. We provided the chart for you that showed the commercial storage in the United States has not grown dramatically. And at the same time, our production has grown dramatically. We have come of 2 back-to-back years of record and near record corn production. And recognizing that problem, earlier this year, we did make some changes in our loan program, and we have allowed the producers to have the opportunity to store their grain on the ground and on the farm if they are having, rather than having to go to a commercial warehouse. We also, I think, would probably like to see more activity in our Farm Facility Loan Storage Program. That program has been around for some time now, where we provide financing to build on-farm storage. I think that that is something that probably needs to be availed of more by producers. But it is a challenge that we have, and I think it is going to be a continual one here if we continue to have good crops here in the future.

Mr. OSBORNE. Thank you, Mr. Chairman.

Mr. MORAN. Thank you, Mr. Osborne. Mr. Gaibler, Secretary Gaibler, the grain sorghum folks seem to be getting a lot of attention today, and I am going to add to that myself. I very much recall the efforts in the last farm bill, in the 2002 farm bill, to equalize the corn and sorghum rates, and again encourage USDA to, through a more adequate fashion, reach that goal. And perhaps it goes back to the comments made by the gentleman from Nebraska, Mr. Osborne, concerning the national versus localized or regionalized rates. One of the examples that the sorghum growers provide in their testimony, they provide an example about the disparity between the corn rate and the sorghum rate.

But another one is about uniformity. I suppose my initial reaction is that uniformity is a good thing, and sometimes it is and sometimes it is not, which I guess is what you all go through in establishing these prices. But their testimony, this is their chart on page 5 of their testimony. October 20, the LDP was 30 cents per

bushel uniformly across 11 towns in Kansas, Texas, and Oklahoma. Our subcommittee staff yesterday checked to see if that was still the case, and it is. Ten of those communities are still at 60 cents and one of them is at 59 cents. So 7 weeks later, the concern that was raised by the sorghum growers about the same LDP being the same in all 11 communities is still true 7 weeks later. Is there an explanation for why that is, that you have not already given us? Perhaps you are going to restate what you have already told us, but that one stands out to me as an example of a number of things, Ms. Musgrave's question about, do we respond quickly to concerns about the county posted price, LDP rates? And then, I guess, just generally, this concern again about, how do we treat grain sorghum as far as a local market?

Mr. FARRISH. Thank you, Mr. Chairman. Secretary Gaibler has asked me to address your question. You are correct, the LDP is still the same. I would point out on the table that these are individual locations, and the prices, cash prices do not represent the posted county price. So in a way, not to cast any negativity on the research on the table, but it doesn't represent exactly how we administer the system, since it is using cash prices versus loan rate and not PCP versus loan rate.

And I guess, at the risk at restating our previous testimony, much of the focus in the past has been to provide level LDP benefits across broad areas, or across all areas and minimize, there is a provision in the statute to minimize differences across State and county lines. And that is a real challenge of the system, is to try to comply with that provision in the statute and yet, at the same time attempt to reflect actual values in those counties.

And I would say, too, that in sorghum in particular, production of sorghum has fallen a fair amount in the last 10 years or so. I think we are around 400 million bushels now. Five or 10 years ago, the U.S. was producing around 800 to 900 million bushels. And as Mr. Yost pointed out earlier, that does make it a challenge to establish values in crops that have lower production levels and are more thinly traded. We experience the same problem in barley and some other crops as well. But that is an additional challenge to the system that we face. It is particular to sorghum and not to corn.

Mr. MORAN. Does it seem odd to you about those 11 cities, 7 weeks apart? Does that strike you in any particular way?

Mr. FARRISH. Well, it strikes me that the market hasn't changed much in the last 7 weeks, initially. Again, we review those every day, on average in those States. We look at State averages, and on average within those States, our PCP is on average within a cent or two of cash prices across the State. That leads us back into a discussion, do we look at the State or do we look at smaller areas, and that is one of the things that we will be examining as we go forward this spring in examining the whole system.

Mr. MORAN. Well, I understand the kind of, perhaps, anomaly of the question, because often we are asking you to uniform, make more uniform from one county to the next. This one does strike me as an example of why there needs to be more localized information in regard to the county posted, posted county price in regard to grain sorghum.

Mr. Peterson, anything additional? Mr. Goodlatte? Ms. Musgrave? Mr. Neugebauer? Mr. Fortenberry?

Thank you all very much for joining us this morning. Thank you for your preparation and your testimony today. Thank you, Mr. Secretary.

Mr. GAIBLER. Thank you.

Mr. MORAN. The chair now would ask to come to the table our second panel of witnesses, Mr. Sherman J. Reese, who is President of the National Association of Wheat Growers; Mr. Greg Shelor, the Vice President for Legislation of the National Grain Sorghum Producers; Mr. Dean Sonnenberg, President of the National Sunflower Association; Mr. John Fletcher, General Manager of Central Missouri AGRIService, Inc.; and Mr. Michael O'Connor, a member of the National Farmers Union. And I would recognize the gentleman from Colorado for introduction from her of Mr. Sonnenberg.

Ms. MUSGRAVE. Thank you, Mr. Chairman. Before I introduce Mr. Sonnenberg, I would just like to acknowledge your work behalf of the region. And the coach was here, and very often Nebraska, Kansas, and Colorado face similar issues such as the severe draught. We also work together for funding for ag research, and I just appreciate your efforts very much. You are a rock star, and if you want to have a field hearing out my way, you would be very popular.

Mr. MORAN. The gentlewoman from Colorado will be regularly recognized.

Ms. MUSGRAVE. OK.

Mr. MORAN. Thank you very much.

Ms. MUSGRAVE. You are welcome.

Mr. Sonnenberg and I met several years ago and got to know each other very well when he would come to the State legislature. He has been on the farm that he grew up farming since about 1975, and I believe corn, wheat, millet and sunflowers, which you have grown probably for about 20 years now, but have been very active in promoting things that were good for agriculture, and have been a good source of information. And it has been a pleasure to work with him through all these years. And of course he is very involved now with the Colorado Sunflower's Administrative Committee. He has done a lot of work with the Logan County Farm Bureau. I think, probably, Dean, you have held every office and have been very active in the Farm Bureau for many, many years. I know that you are engaged in a lot of forums, promoting the production and the marketing of sunflowers. I note the tie you have on today; always promoting sunflowers. And right now, Mr. Chairman, he is president of the National Sunflower Association and he had been appointed 5 years ago. So I am proud to introduce Dean as someone who has worked very hard on behalf of agriculture and have done a good job of it now for many, many years. Thank you, Mr. Chairman.

Mr. MORAN. Thank you, Ms. Musgrave. As a person who represents the Sunflower State, I appreciate the remarks you make about Mr. Sonnenberg and his leadership. We welcome all of you, Mr. Sonnenberg and others, to our subcommittee hearing today, and I would recognize Mr. Reese to begin his testimony. Thank you very much.

**STATEMENT OF SHERMAN J. REESE, PRESIDENT, NATIONAL
ASSOCIATION OF WHEAT GROWERS**

Mr. REESE. Thank you, Mr. Chairman. Mr. Chairman and members of this committee, my name is Sherman Reese. I am currently serving as the President of the National Association of Wheat Growers, and I am an active wheat farmer from Echo, Oregon. Thank you for this opportunity to be here today. I look forward to sharing our thoughts about the loan program as it is currently structured, and some unintended impacts that it is creating.

Wheat growers as a whole have not been able to make use of the loan program as established under the 2002 farm bill. Part of this is a result of persistent draughts in wheat States, and with no crop to sell, there is no loan program benefit. And part of it is a perception by producers that other crops have a more attractive safety net or are otherwise more competitive. We believe that there are several issues that need to be addressed if the loan program is to be retained in the next farm bill, but I would like to spend my time today discussing discrepancies in posted county prices and their effects on loan deficiency payments, and touching on a particular issue in a class differential.

The methods used by USDA to calculate posted county prices have an arbitrary and unpredictable effect on loan deficiency payment rates. Posted county prices are calculated by subtracting the county differential from the appropriate U.S. terminal market price. The county differential reflects the cost of moving the commodity from that county to the terminal market, plus additional factors such as local demand and local markets. These additional factors appear to be subjective values with no established formula, giving rise to discrepancies between posted county price and the actual cash price. These discrepancies are exhibited through posted county price values both far above and far below actual cash price for a county.

Recent swings in these values range from 19 cents under cash price to 18 cents above during the period of May 17 to August 11, 2005 for winter wheat in Choteau County, Montana. Spring wheat posted county price ranged from 16 cents under to 72 cents over during that same time. These discrepancies are unacceptable, not only because of the inconsistency, but for the possible failure of a safety net for farmers who rely on loan deficiency payments when markets fail to provide a price that covers the cost of production. A possible remedy is for USDA Farm Service Agency to periodically canvas county grain elevators to determine an average local cash price in order to adjust the differential so the posted county price would more closely reflect the actual cash price.

I should also point out that a few years ago, USDA had some large differentials between adjacent counties for loan rates. In my area there were two adjacent counties, and that would be Umatilla County in Oregon and Walla Walla County in Washington, with 12 cents difference in county loan rates. The USDA has been responsive to our requests to smooth these out, and while there may still be some issues out there, they have been largely resolved and we thank the Department for doing so.

Let me touch on some results for USDA's decision to separate loan rates by class of wheat. We were not aware of this proposal

during negotiations for the 2002 legislation, so the administration's decision to separate them by class came as a bit of a surprise for NAWG and its member States. Everyone knew there would be adjustments, and some of these have had different regional impacts. This distribution of impacts is very difficult for a national organization with members in all regions and classes to address.

NAWG supports the principle established by the 21st Century Commission which was chartered in the 2002 law; that the purpose of Federal agricultural policy is to "provide a safety net under farm income with minimal market distortion." This principle guides our preparation of proposals for the 2007 farm bill, and it guides our response to the question of regional loan rates. If administration decisions are causing growers to shift from one class of wheat to another, when the market is sending different signals, then Federal policies need to be changed. If, however, class loan rates are following true market signals that are accurately conveyed and not distorted through arbitrary or subjective adjustment factors, then the program is working as advertised and is consistent with the 21st Century Commission principle.

We have received complaints from some soft white wheat producers about the differential on loan rates between hard red and soft white wheat in the Pacific Northwest. They contend that USDA decisions and adjustment factors result in a lower loan rate from soft white than would otherwise result, and then in response, farmers are shifting from soft white to hard red. Our response to those States has been consistent with what I just said: if the market is driving those differences, free from subjective interference, then the program is working properly. If there are subjective or arbitrary adjustment factors or policy decisions that are driving planning decisions, it is not working properly and NAWG will support getting it fixed.

Therefore, we suggest that the subcommittee conduct a thorough review, confidential if necessary, of the exact formula and methodologies for determining adjustment factors by USDA to satisfy the question of whether subjective adjustments were made. You should ascertain whether the loan rates for those classes of wheat are truly following market signals or whether there is interference in those signals. NAWG would be very happy to participate in that review. Once that information is known, we will all have a better idea of appropriate remedies, should they be necessary.

In conclusion, I would like to reiterate our belief that the loan program has not worked efficiently for wheat producers and has caused wheat producers to miss out on a major part of the farm safety net. NAWG members understand that due to our commitments within the World Trade Organization and tight budget situations in the Federal Government, we need to start looking towards more green box programs for the next farm bill. We should keep the 21st Century Commission's principle in mind and provide support through less market-distorting mechanisms. NAWG members have already begun putting together potential proposals for the 2007 farm bill that will allow wheat producers to use more of the farm safety net while keeping planning flexibility and keeping our WTO commitments. I look forward to sharing these proposals with the committee in working with you as you begin drafting legisla-

tion for the 2007 farm bill. I am ready to answer my questions about my testimony today. Thank you.

[The prepared statement of Mr. Reese appears at the conclusion of the hearing.]

Mr. MORAN. Thank you, Mr. Reese. Mr. Shelor, welcome.

**STATEMENT OF GREG SHELOR, VICE PRESIDENT,
LEGISLATION, NATIONAL SORGHUM PRODUCERS**

Mr. SHELOR. Thank you. Mr. Chairman and members of the committee, my name is Greg Shelor and I produce grain sorghum, wheat, corn, and soybeans near Minneola, Kansas, which is in the southwest part of the State. I serve as Vice President for Legislation of the National Sorghum Producers, and appreciate my first opportunity to represent this organization before the House Agriculture Committee. I would like to thank you for the interest in sorghum, and the review of the technical procedures of USDA's establishment of posted county prices. I would also like to thank USDA for implementing the eLDP Program, which has sped up the process of farmers receiving their loan deficiency payments in a timely manner. However, I would like to see USDA change the publication of loan rates and the LDPs to a bushel basis. This would help clarify numbers for our producers.

USDA implementation of the LDP Program, where LDPs are determined by posted county price, is of utmost importance to our members. And this issue has generated more inquiries to our office than any other issue this year. Our members are saying they are frustrated because they don't understand how USDA determines the LDPs, and it seems arbitrary to them. They are especially frustrated when they see large changes in the LDP when the market did not change. This is due primarily to the switch from the county LDP system to a regional LDP system, which has taken the regional size to an extreme.

On October 20, the LDP was the same, with the exception of an area in south Texas, for the top eight sorghum producing States, Kansas, Texas, Nebraska, Colorado, Oklahoma, Missouri, Illinois, and South Dakota. These States produce 95 percent of the grain sorghum in 2004, and NSP feels this area is too large for one single LDP to be set by USDA.

As we have contacted USDA with our concerns regarding this program, they have been receptive to work with producers in correcting the LDP Program's problems in the Sorghum Bill. Last week, national staff met with the FSA staff, asking that the regional LDP system be revisited, and that the regions used to determine the LDP be changed to smaller regions. We look forward to working with USDA to help them better understand the dynamic changes occurring in the sorghum market.

On October 20, the cash price for sorghum in Dodge City and Russell, Kansas was the same at \$1.52 per bushel. The LDP was also the same at 30 cents per bushel. However, the loan rate in Russell is 15 cents per bushel less than the loan rate in Dodge City. This means there was a 15 cents per bushel discrepancy in LDP. Dodge City was 11 cents per bushel low and Russell was 4 cents to the high. The Russell market is influenced by a local ethanol plant, and this is reflected in the cash price. As currently im-

plemented, a regional LDP system cannot accommodate such variations in local markets, and weakens farmers' confidence in the system.

Some may ask why producers don't place the grain under loan in such instances. Farmers are caught in a cash flow squeeze with low commodity prices and high energy prices. From a cash flow standpoint, the cash price plus LDP is better than putting grain under loan and prepaying at 27 cents per bushel storage. With little on-farm storage as compared to the Corn Belt, sorghum farmers are limited in using loan programs as cash flow, and instead use LDP as a cash flow tool. With cash flow being an issue this year, the errors in the LDP rates add up to a large cash flow issue for farmers. Just recently as the day before yesterday, my cash price plus LDP was 7½ cents per bushel less with the regional system. Doing some quick math, this 7½ cents per bushel discrepancy on the 187 million bushel Kansas sorghum crop equates to \$14 million not going into Kansas producers.

National Sorghum Producers is committed to working with the committee, its staff, and USDA to ensure proper implementation of the Farm Security and Rural Investment Act of 2002. Sorghum is a vital part of many producers' operations and must receive equal treatment by USDA. USDA implementation of the LDP Program, which is determined by the posted county price, must not interfere with farmers' cropping decisions. Thank you.

[The prepared statement of Mr. Shelor appears at the conclusion of the hearing.]

Mr. MORAN. Mr. Sonnenberg.

STATEMENT OF DEAN SONNENBERG, PRESIDENT, NATIONAL SUNFLOWER ASSOCIATION

Mr. SONNENBERG. Mr. Chairman and members of the committee, thank you for your invitation to testify today about the procedures the USDA's Farm Service Agency uses to establish posted county prices for commodities. I am the President of the National Sunflower Association, and I am testifying today on behalf of the association. I am a producer from Fleming, Colorado, where we raise sunflowers, corn, wheat, and millet on our farm.

The safety net provided for sunflowers by the 2002 farm bill, as with other oil seeds, relies primarily on the Marketing Loan Program. The direct payment rate for sunflowers is nominal and the counter-cyclical rate is virtually nonexistent. We are happy to report that until this fall, oil sunflower prices, the basis upon which both confection and oil sunflower LDPs are determined, had been above the loan. And so virtually no LDP activity has taken place from 2002 through 2004. And this did contribute significantly to the savings that have been posted by the 2002 farm bill, relative to the original CBO score.

Because of higher prices, NSA did not have a reason until this year to review the effectiveness of either the terminal market locations or the freight differentials to each county that is used to determine sunflower PCP. However, this past harvest, record yields, coupled with significant increases in acreage and high delivery volumes at harvest, did cause oil sunflower cash prices to decline significantly from those seen in 2004. Conversely, the high diesel fuel

prices that we saw this fall caused freight rates to rise significantly. The combination of those two factors has driven the price of oil sunflowers below loan level in many markets.

The sunflower PCPs did not originally track those declines, and producers notified the NSA about the growing spread between PCPs in their local market. The NSA contacted the FSA about the divergence, and I would really like to thank them for the speed at which they were able to respond and bring those back into sync. About 14 days transpired, for the congresswoman's question of earlier. I was impressed to see that anything in the bureaucracy could move that fast. I understand and it may be clarified today that the freight differential at the local markets was suggested by removing a single dominant market and was replaced with a combination of two or three regional market points in order to refine the calculation that determines the local PCPs.

The NSA believes that higher and more volatile diesel fuel prices seen this fall played a major role in causing that divergence. We also believe that this climate of volatile prices will unfortunately stay with us for a time to come. As a result, the railroads have already devised a baseline energy index formula to reflect moving fuel costs that are then added as a surcharge and hopefully as a discount when warranted to a base freight rate. For instance, reports of surcharges topping \$500 per railcar over and above the posted freight rate were not uncommon during this harvest. Although sunflowers are primarily moved by truck, the higher rail rates dictate all freight rates. With the dynamics of today's energy market, perhaps the PCPs need to include a similar formula to reflect moving fuel costs. And since surcharges vary by region, such a system would need to be implemented regionally.

Another factor magnifying the effect is the changing dynamics of the sunflower market itself. There are fewer and fewer delivery points for sunflowers. In the case of Colorado, there are 107 terminal elevators, or warehouses, and only 30 of them purchased sunflower at all in the last 3 years, and fewer than 10 of them are in the market on a daily basis. The railroad increasingly wants unit trains of 52 or 110 cars, so there are fewer and fewer places deliver. So far more farmers are contracting directly, and the distances to the markets have grown significantly.

In listening to the previous testimony, it seems important to ask the question about what is a terminal market. In the oil sunflower complex, 25 percent of the production moves into the bird seed. And in Texas, Oklahoma, Kansas, Colorado, and Nebraska and Wyoming, that figure is 50 percent. And in the cases of areas like Missouri and Illinois, it may well be a hundred percent. While ignoring that effect may maximize payments to our producers, it probably penalizes us later as our loan prices may fall. In today's ag money market, the value of my insurance coverage is directly proportional to my ability to borrow operating capital.

In closing, I want to thank the subcommittee for the opportunity to testify on this issue, and I would be glad to offer the services of the National Sunflower Association if you need further information. I would be glad to answer your questions. Thank you.

[The prepared statement of Mr. Sonnenberg appears at the conclusion of the hearing.]

Mr. MORAN. Thank you. Mr. Fletcher.

**STATEMENT OF JOHN FLETCHER, GENERAL MANAGER,
CENTRAL MISSOURI AGRISERVICE, INC.**

Mr. FLETCHER. Good morning, Mr. Chairman. Chairman Moran and members of the subcommittee, my name is John Fletcher. I am General Manager of Central Missouri AGRIService, LLC in Marshall, Missouri. Our company is a joint venture between a family-owned company and two cooperatives. CMAS operates our country elevator, farm supply, and feed manufacturing business in west-central Missouri. And I am testifying today on behalf of the National Grain and Feed Association.

On a national basis, our sense is that USDA generally did a good job this year of monitoring and adjusting PCPs to keep them roughly in line with cash market prices in local areas during what was a difficult harvest situation, complicated by large crops, hurricane disruptions, and rapidly escalating freight rates. Unlike some previous years, the NGFA's office generally received a lower volume of calls and complaints about PCP anomalies than we have had in previous years; however, there have been some exceptions. Mid-October, several NGFA member elevators began reporting that sorghum PCPs were not reflecting the local cash prices in several areas of Kansas.

In my home State of Missouri, the gap between PCPs and local elevator prices were significantly wider this year during the peak of harvest compared to the previous years. For instance, in some areas of Missouri, the PCP was 20 to 30 cents higher than the local prices, resulting in lower net prices to the farmer. While in others, the PCP was 10 cents lower, resulting in local prices, the total price being 10 cents higher than the loan rate. However, it appears that most of that differential disappeared during the post-harvest period, which leads us to believe that the spike in harvest transportation cost is attributable to extremely tight transportation capacity constraints, and the disruption caused by Hurricanes Katrina and Rita played a direct role.

To improve the existing system would require a substantial increase in the market price sampling points that USDA contacts daily to include more localized markets. One of the real challenges in this regard is a trend in markets away from terminal market-based pricing, as many grain movements occur directly between the originating elevator to the customer, such as a feed mill or an ethanol plant, bypassing traditional terminal points in the process. This makes local market prices much less predictable, unless individual local markets are monitored daily.

In addition, USDA would need to devise a system that more adequately incorporates changes in transportation costs to reflect the actual freight rates for barge, rail, truck, or actual freight costs to specific market destinations, because freight rates can fluctuate dramatically, particularly given the impact of the carrier-imposed fuel surcharges. The bottom line is that the current system used by USDA, given the human and financial resources allocated to it, is doing about as well as can be expected. Currently, USDA relies on producers, grain elevator operators, and market observers to provide assistance in alerting the Department if PCPs are out of line

with local cash markets in certain geographic areas. At times, the NGFA itself has been alerted to such PCP anomalies by members and has notified the USDA headquarters. Generally, our experience has been that these reports are investigated quickly and efficiently by USDA; however, there is always a however, we have received reports from some member companies expressing frustration with the Kansas City Commodity Office's responsiveness after reporting PCP anomalies.

To rectify this, NGFA suggests that the USDA establish a more transparent, systematic, and better defined method, perhaps a web-based system of some sort for reporting instances in the future, when LDP payments plus local cash price is out of line with the loan rate. We also believe that USDA could be more transparent in explaining the general parameters it uses for investigating the PCP anomalies and the factors it uses to determine whether adjustments are warranted.

NGFA would also encourage the USDA to revisit another component of the Marketing Assistance Loan Program that has been problematic in restricting the ability of producers to utilize modern risk management tools when contracting to sell grains and oil seeds. I am referring to the beneficial interest, that is, title control, risk of loss, and the commodity to be eligible to receive loan deficiency payments or the Marketing Loan Program gain. The problem is that the concept of beneficial interests is out of kilter with various kinds of new generation cash grain contracts that offer producers opportunities to maximize market returns. USDA has ruled that certain types of advanced sales contracts, contracts to sell, price later contracts, and contracts for future delivery of grain violate the beneficial interests rules, because these contracts give the buyer an interest in the commodity at the time specified in the contract or a time implied by law.

We think that there is something amiss when a government farm program that is designed to divert forfeitures, encourage stocks and inter-market channels, and maximize farm income, has the unintended and perverse effect of limiting the marketing options available to producers. The NGFA believes that USDA has the legal authority under the current statutory language to revisit the beneficial interest issue to bring it more into line with the current market environment. If USDA's analysis reveals that it does not believe that statutory authority is sufficient to modify the current interpretation of the beneficial interest rules, Congress may wish to revisit the statute as part of the 2007 farm bill.

Mr. Chairman, that concludes my statement. I would be pleased to submit to questions. Thank you very much.

[The prepared statement of Mr. Fletcher appears at the conclusion of the hearing.]

Mr. MORAN. Thank you, Mr. Fletcher. Mr. O'Connor.

STATEMENT OF MICHAEL O'CONNOR, MEMBER, NATIONAL FARMERS UNION

Mr. O'CONNOR. Thank you, Chairman Moran and the rest of the subcommittee for holding this hearing, and providing me the opportunity to share with you some of my concerns with the posted county prices. I am Mike O'Connor. I am a member of the South Dakota

Farmers Union and testifying on behalf of the National Farmers Union. I am an independent family farmer, raising corn, soybeans, and some cattle. I served as the State executive director of the FSA for 10 years, or 8 years under President Clinton, and I also served as the Jerauld County FSA director for 2 years.

If there is one thing that the independent minded farmers can agree upon, it is the confusion and the complexity of setting the posted county price. The process is something very few can clearly explain or comprehend. A familiarity amongst producers is a system that is inconsistent and unreliable. As a producer and a former FSA State director, I have had the unique opportunity to witness the complexities of the posted county prices from both sides. Producers get very frustrated because they try to figure out how the system works, and by the time they think they have it figured out, it does the direct opposite.

My home county of Union County, South Dakota bases its posted county price off of the higher of the two terminal markets, one in Minnesota and one in Portland, Oregon. With the added differentials and discounts such as transportation, more than often the posted county price is out of touch with the local market. One out of every three rows in South Dakota is processed into ethanol. Because the loan rates are set a distance from the market and the value-added market, such as the ethanol market, have not been taken into consideration to the account that I think they need to be.

Just to give you an example, a week ago, in a grain elevator in Beresford, South Dakota, corn was selling for \$1.60, but the ethanol plant less than 8 miles away was \$1.80. That is a 20-cent difference right there. The price of corn for the Board of Trade usually sets the local markets, including the ethanol plant. Most producers understand the Board of Trade and how it works, and they think the posted county price should follow the Board of Trade, but it doesn't always do that. There is occasions when the Board of Trade closes higher or lower, and the PCP does the direct opposite. This is very frustrating for many producers who want to understand the PCP process and to be better marketers of that commodity.

One of the biggest problems producers see is the PCP is consistent with the differentials. The transportation differential this year was undoubtedly compounded by skyrocketing energy prices. Energy surcharge tacked on by transportation entities, whether it is rail, ground, or barge, are paid directly out of the producers' pockets, but also impact the degree of the differentials used to establish that posted county price.

Evidently, differentials can be altered to fit the situation, thus being reactionary in nature. And this really happened to a great extent in 2004, where the posted county price was actually higher than the local market at the end of the summer in 2004. USDA did not want all this forfeited and was able to make some type of adjustments to add to the differentials and the PCP. This resulted in many of the loans being bought back, but also caused significant differences between across State lines and county lines. There seems to be black hole when that is done with other deductions that nobody can explain.

The increasing transparency in establishing differentials would go a long way in understanding how PCPs are set. At the time a PCP between counties is different with no explanation, the PCP between two neighboring States are often off, too. Let me give you an example, the corn buyback in four counties in my area, two in South Dakota and two in Iowa. From July 1, 2005 through September 30, 2005, South Dakota had a higher buyback rate, 29 of those days, averaging 3½ cents higher. Iowa had a higher buyback, 16 of those days, averaging 2 cents higher than South Dakota.

There is no quick and easy solution that would be perceived as fair to all producers. Determining the responsible party for this discrepancy would be a step in the right direction, whether it is the USDA or the grain merchandisers. I would also encourage this greater transparency into the process of setting posted county price with the better utilization and reflection of the local markets. I thank you, Chairman Moran, and the rest of the committee, for this opportunity, and I will try and answer questions.

[The prepared statement of Mr. O'Connor appears at the conclusion of the hearing.]

Mr. MORAN. Mr. O'Connor, thank you, and let me start by asking you a question. Your time as a State FSA director catches my attention. Are things different today than they were then? Are we making progress? Are things about the same? Are we making or having a more difficult time in establishing the right posted county price today than we did 10 years ago?

Mr. O'CONNOR. Chairman Moran, things are not different. The only time that they are different today would be when the market price is above the loan rate, and that takes care of all the problems, otherwise the problems existed 10 years ago. And that was a problem that I had to address between neighboring States, where South Dakota wasn't receiving anything and our neighboring State, Iowa, was 6 or 8 cents.

Mr. MORAN. In regard to that question, and for all members of the panel, it does seem to me that there is this desire to have more uniformity across county lines, but at the same time, that uniformity can in itself be a problem, that we want things more localized. So which direction is it that USDA needs to go? Do we need more localized input, market information, in establishing the posted county price? Are we looking for more uniformity so that from one county to the next or across adjoining State lines, the posted price, and ultimately the LDP, is the same or similar? What would we tell USDA they should do? It is either a great question or a poor one.

Mr. O'CONNOR. I will take a shot at that. I think a little of both. I think that local input is really important. And the second thing is again, I think they have to review these differentials and these loan rates to see if they are actually reflecting the difference in such a short or a small area in southeastern South Dakota and northwest Iowa and Nebraska, Minnesota. There isn't a whole lot of difference in the marketing areas, especially with the new ethanol plants coming up. So I think you have to take a little of both, but local input certainly should. But the biggest key, whatever they do, they need to make it so that the average producer can take a look at it and see what they have done.

Mr. MORAN. Mr. Reese?

Mr. REESE. With regard to wheat, the problem we have, of course, is having the 6 market classes identified. And if you have more than one market class in a county, it becomes really problematical, because you have, for instance, a \$3.20 loan rate for hard red winter wheat versus maybe a \$2.70 loan rate for soft white winter wheat in my area. So for us, we need to find out a way internally within our crop to find a way to make that discrepancy go away, because that is having unintended consequences in terms of planning decisions, which may or may not follow historical trends for those particular areas.

I think, with regard to USDA and what they have done, Mr. Farrish is a friend of mine and has always been very accurate and timely in responding to our questions. But the perception, and I think you have heard that from this panel, the perception out there is that there is a lot voodoo economics, and I am not sure what the correct answer is. We just don't have, any of us as farmers, we don't really have a good idea. We know that there is production, we know that there is price, and we know that there is bases. So those three items are involved in how they determine these PCPs, but nobody on my side of the street understands it well enough to fully comprehend what is going on.

Mr. MORAN. Mr. Sonnenberg?

Mr. SONNENBERG. In the case of sunflowers this year, uniformity was what we needed. We have oil processing capability in North Dakota and in Kansas. If the market is moving to Mexico, Kansas has a price advantage. If the market is primarily domestic oil, the Dakotas have an advantage. So as we came into harvest, we were a dollar lower on the price in Colorado and Kansas, and that wasn't being reflected in the LDP. And it was very beneficial to the growth of the industry in the future to realize that we in the south that participate in the market, even though the price reward was for growing in the north. So uniformity was important to us.

Mr. MORAN. Mr. Sonnenberg, in that regard, it wasn't too long ago in which there was concern raised about the LDP rate between confectionary and oil seed within sunflowers and the effect it was having upon planted acres. Has that issue been resolved?

Mr. SONNENBERG. We really went to a single class to a large extent, as far as the loan was concerned, so as not to create an artificial differential between them, and allow the marketplace to buy what it needed irregardless of what happens with the loan rate. So I think that that is taken care of.

Mr. MORAN. That is a change that has occurred within the last several years?

Mr. SONNENBERG. Yes. For a short time they were separated, and it seemed more divisive than having it unified.

Mr. MORAN. So there is one loan rate today across the spectrum for confectionary versus oils.

Mr. SONNENBERG. That is correct.

Mr. MORAN. OK. Anyone else? Mr. Fletcher?

Mr. FLETCHER. Sure. I would like to add, the current system for determining PCPs is 20 years old. We tweak it here, we tweak it there. But this fall, typically, I am in west-central Missouri. Typically, St. Louis markets will be 15 to 20 cents higher on corn that

we are. This year, we were 20 cents higher than they were on corn. Well, you get an anomaly like what Hurricane Katrina caused and things are going to get messed up. And then USDA steps in and tries to fix that and it causes a ripple effect, the rift that they spoke of.

I think part of the problem is, the loan rates vary from county to county, so you could have one PCP across a State, but if the loan rates vary, then the LDPs are going vary from county to county. If the loan rates were more uniform, if there wasn't a 10-cent higher loan rate in Jackson County, Missouri than there was in Lafayette County, Missouri, then you wouldn't need to have a different posted county price in order for LDPs to be the same. I do think, and I don't know the entire national system. In our county, it would be a 3-minute process for the local county office to determine what the posted elevator prices are on a given day and enter that into some database that could be monitored in Kansas City to look for things being out of sync. It would be a monumental task for somebody in Kansas City to check every elevator or every market in the country. But I think if you delegated that out and entered it electronically into some kind of web-based system, it will be really easy to do. I think it would be a lot easier to monitor.

Mr. MORAN. Elevator operators across the country would have that capacity, have that ability?

Mr. FLETCHER. No, I am saying the local county office would.

Mr. MORAN. The local county office. I wanted to make sure you weren't volunteering.

Mr. FLETCHER. No, no, absolutely not. Well I think there needs to be some accountability on it, and I think that the local county office could better determine what the companies that were buying grain in their markets were paying for grain.

Mr. MORAN. Thank you, Mr. Fletcher. Mr. Peterson?

Mr. PETERSON. Thank you, Mr. Chairman. And, Mr. O'Connor, Congresswoman Herseth sends her regards.

Mr. O'CONNOR. Thank you.

Mr. PETERSON. She wanted you to know that she thinks highly of your leadership, and she is down at the White House at a briefing right now or she would have been here. So I wanted to convey that message.

Mr. O'CONNOR. Thank you.

Mr. PETERSON. And I guess, for you, is it fair to say that farmers knew that there was going to be a backup in the corn market, even before Katrina hit?

Mr. O'CONNOR. Yes, very much so. I think that, at that time, Congressman Peterson, I think the terminals were full and I think there was a lot of loans maturing and were moving into the marketplace. And I think it all started about July 3 or 4, right in there, when the market turned around and headed in the other direction. It headed down.

Mr. PETERSON. And don't you think a lot of this pressure, that we have got such a terrible pricing situation going on here, that that is a lot of what is causing some of the concern out there, that it is not working? We are not getting the kind of prices out of the marketplace?

Mr. O'CONNOR. Absolutely. If the marketplace would establish a decent price, we would not have these type of problems with the disparity in the PCPs and loan rates. And that would be the answer to most of the problems, a fair price.

Mr. PETERSON. Thank you. I guess to any of you, most of the complaints that we hear about the operation of the program, and a lot of the complaints are about farmers shopping around for the highest LDP, what is your reaction or experience with farmers chasing LDPs? Is that a common thing as opposed to them trying to find the highest cash price?

Mr. FLETCHER. One thing that we have commented on, I have been in the industry for 25 years, and it used to be that the farmer was always wanting the price to go up. In the fall of the year, we find the farmer wanting the price to go down so he capture a higher LDP. It is almost unnatural.

Mr. PETERSON. Any of the others have a comment?

Mr. O'CONNOR. Congressman Peterson, I don't see that as much, and didn't as the State director, of chasing the higher LDP. Again, if they would have to use commercial storage, sometimes the producers would haul it to that particular terminal where the loan rate was higher so they could get a higher loan rate, and eventually that may turn into a higher or a better price in the form of an LDP, or the buyback when they bought it back, but I didn't see that as so much chasing it in the years that I served there.

Mr. SHELOR. In our area in southwest Kansas, we don't have that many options for markets. It is quite a ways to the next elevator. So with the price of fuel and stuff, you can't afford to go too far looking for a better price. So you are pretty well limited on that. So there is not much of that in our area.

Mr. PETERSON. Are you from Minneola, Kansas?

Mr. SHELOR. Yes.

Mr. PETERSON. I think I landed there about 3 or 4 weeks ago. I think that is where I was. There is a little airport there and there is a stockyard right southeast of it.

Mr. SHELOR. Well, there is not—

Mr. PETERSON. That doesn't narrow it down much, does it, Mr. Shelor?

Mr. SHELOR. No.

Mr. PETERSON. Maybe I was mistaken. But what I was concerned about, I was flying down and there was this big head wind, so I had to land in this little town to get gas in my plane, and there was nobody around on a Sunday morning, but they had the pump on. And so I filled it up and left a check. I was just hoping that the town fathers got the money.

Mr. SHELOR. Well, we don't have a local—

Mr. PETERSON. I am not sure where I was, but I was someplace in Kansas. And every time I fly over Kansas, Mr. Chairman, if the wind is blowing 40 miles an hour, I don't know why you don't have a lot of windmills out there.

Mr. MORAN. A rare day in Kansas when the wind isn't blowing, Mr. Peterson.

Mr. REESE. I guess I would like to take a stab at what the congressman asked. In regard to wheat, I think we have to be careful. One of the things that we wanted to have was a loan rate low

enough to keep us from building stocks again. And yet, because of these class differentials that we are experiencing in wheat, then you start seeing people wanting to see a higher loan rate, relative to another class so that they can sell that class that they are growing and collect the LDP accordingly. And so it is real tightrope for us to find someplace where we can have an LDP collected for wheat without having a loan rate so high or that we end up with a lot of forfeitures and a lot of price-depressing, farmer-owned or government-owned reserves.

Mr. PETERSON. I have heard that concern, too, but I have to tell you, in my part of the world right now, they are telling me that they are not going to plant wheat next year because they can't make it work. So I am not sure that is going to be a problem, from what I am hearing. Thank you, Mr. Chairman.

Mr. MORAN. Thank you, Mr. Peterson. Chairman Goodlatte? Mr. Neugebauer?

Mr. NEUGEBAUER. Thank you, Mr. Chairman.

Mr. Shelor, you heard me talk to the secretary a while ago, and about that he has been working with the sorghum group. Have you found the administration receptive as you all have brought these issues in front of them?

Mr. SHELOR. Yes, I believe they have, with our staff and their staff. They correct the problem, but then it doesn't seem—back in October it was corrected and now it is off again, so it doesn't seem to stay corrected. But yes, they have been real receptive and get right on it. And I have noticed locally, it will be readjusted within the next day back in line. But then, as time goes on, then it gets back out of line.

Mr. NEUGEBAUER. Have you all sat down with some specific changes to the program that you think might be beneficial and cause less tweaking or the need to call and say hey, things are out of kilter? Have you all brought some thoughts and ideas to the table?

Mr. SHELOR. I am not sure what team has done on that, but I believe their recommendation is to get into smaller regions, because right now it is seven or eight States, which is just way too large. And even getting down to some mass reporting districts or something to get them districts, because even our own States, we have a lot of different markets, whether it is an ethanol plant or whether it is cattle feeding or something, we have got specialized markets and that affects each one of the regions differently. So it needs to be a smaller reporting district on that.

Mr. NEUGEBAUER. And it has been represented that there was a concern that because of these differences, we were going to see a major shift from some of the folks that were planting sorghum to possibly moving to corn or to other grains. In Kansas, for example, or in the region, have you seen a shift towards producers moving from sorghum to corn because of the differences?

Mr. SHELOR. Yes, we keep seeing the reduction every year because the price is that much less. And then you have that discrepancy of 10 to 15 cents, then, at harvest time. So yes, we do see reduction in acres.

Mr. NEUGEBAUER. And I think the gentleman from Nebraska made the point that the amount of water required for grain sor-

ghum is substantially less than for corn. At what point in that process does the input cost, and particularly with these high energy cost and the cost of irrigation and so forth, what would be a tipping point between a producer looking at these differences between corn and the sorghum, and the input cost in moving to, say, corn or another commodity?

Mr. SHELOR. Well, they just kind of have to set it down at their own farm, because every area is different on what their production is, so you have to sit down and run a cash flow on that to see, like to say, a fourth less water and input costs in the way of fertilizer and stuff. So I presume it would be close to a 25 percent difference in that. It is where they would look at planting sorghum over corn.

Mr. NEUGEBAUER. So you would say a 25 percent difference in cost in the input, probably, between corn and sorghum?

Mr. SHELOR. Yes. I haven't sat down and put the figures on my own farm to that, and it could even be more, because a lot of our inputs or our seed costs and stuff are a lot less, so it could even be greater than that.

Mr. NEUGEBAUER. Any other of the panel want to respond to how you felt like the administration is responding to this issue? And do you have some other specific suggestions that maybe we haven't asked about this morning? Thank you, Chairman.

Mr. MORAN. Thank you, Mr. Neugebauer.

Mr. Shelor, we thought we had success in the 2002 farm bill in equalizing the loan rate on corn and sorghum. How close are we? What has happened since then?

Mr. SHELOR. First, the loan rate in my county is \$1.93 on sorghum and it is \$2.10 on corn, which sounds high on corn, but we have extremely good basis there on our corn because of the cattle feeding and stuff. So they are willing to bring that up there. So that would be 17 cents difference on the loan rate.

Mr. MORAN. And, Mr. Fletcher, you talked about something that really did catch my attention. We may need to have a hearing on beneficial interest. That is another topic that gets our phones to ring. But you specifically talked in your testimony about the new beneficial interest form that came out in August. It has an unintended effect of limiting the marketing options available to producers. Would you explain that? Maybe you didn't say that.

Mr. FLETCHER. The form that came out in August basically was a no foul, no harm, no foul deal. If a guy delivered his corn against a contract, it got applied against the contract before he claimed his LDP, then he would assume to have asked for the LDP that he lost beneficial interest. I think that helped keep someone from accidentally not getting an LDP on a certain portion of their bushels, but what has happened with this farm law is, you have gotten into a situation where someone who is aggressively marketing his crops will forward sell his crop and then assume that he is going to get a LDP that adds to the price that he got for his crop. And if something happens in the meantime, he doesn't pull that LDP trigger at the time he intended to.

Mr. MORAN. In trying to correct a common mistake, a common problem in not having beneficial interest—

Mr. FLETCHER. I don't think the new form created, and I will ask my staff people behind me if I am misunderstanding this, but I

don't think the new form created a new problem. It was a partial correction to an existing problem, and the existing problem was that we have—

Mr. MORAN. Unintentionally lost beneficial interest.

Mr. FLETCHER. Yes.

Mr. MORAN. And the form is helpful or harmful?

Mr. FLETCHER. It is helpful to the point that if someone unintentionally loses beneficial interest, he gets the LDP on the day that he would have lost beneficial interest. He may anticipate that he is going to take a 30-cent LDP, and instead he happened to lose beneficial interest on the day when it was 7 cents.

Mr. MORAN. OK.

Mr. FLETCHER. But the unintended consequence of the whole beneficial interest deal is that it makes more difficult for a guy to use the marketing tools that are available to him. And I would point out that I have customers who won't forward contract grain. We talked about getting a decent price for the crop. We bought a lot of corn this year for \$2.30, \$2.40 back in the spring when they could forward contract. December corn was \$2.60, \$2.65. But a lot of guys just simply won't pull the trigger because there is risk of not being able to deliver that grain when he knows he has got the loan rate to back him up. And the simple fact is, and I am not encouraging this in any way, shape, or form, but if the loan rate wasn't there, he would be more aggressive in forward selling his crop.

Mr. MORAN. I don't know how to address that.

Mr. FLETCHER. I don't know either. If you figure it out, I would like to know.

Mr. MORAN. In many ways, that is the purpose of the program. But what you are telling me is, it may cause some folks to take less prudent or less business oriented decisions.

Mr. FLETCHER. That is correct.

Mr. MORAN. Mr. Sonnenberg, you talked about the changing dynamics of the sunflower market. What is going on just generally in sunflowers that you are talking about?

Mr. SONNENBERG. Two years ago there were 4 large oil processors that were active in the sunflower. Today, the one at Red Wing, Minnesota no longer accepts oil sunflowers at all. And the two at Fargo and Enderlin are only 20 miles apart. They control 80 percent of the crop. I think that they are more less considered a single point, just because they are so close geographically. And so the remaining large processor is only 20 percent of the crop and is located in Kansas. So we have lost markets and spread in the markets, and we have changed the market in the last few years from being primarily an export market to being primarily a domestic market. And that emphasis has shifted the pricing burden primarily to the north as opposed to being divided between the Kansas market and the North Dakota market.

Mr. MORAN. Thank you. Let me see if Mr. Peterson has anything further before—thank you, Mr. Peterson. Just a couple of kind of concluding comments. Was there anything that you wished, while you were sitting out there, that we would have asked USDA that we did not? We will be glad to follow up with them with additional questions if there is something that stood out to you.

Mr. O'CONNOR. Mr. Chairman, the only comment that I would make on that, again, I guess the question I would ask him is, why can't they expose what they are using and make it more transparent to me as a producer and everyone else involved in this?

Mr. MORAN. Thank you.

Mr. FLETCHER. We would like to know if they think they have the statutory authority to deal with the beneficial interest question.

Mr. MORAN. OK. And then, finally, does this discussion lend itself to any thoughts that you all have about the 2007 or thereafter farm bill, something that we ought to be aware of, particularly in relationship to this issue? Mr. Sonnenberg?

Mr. SONNENBERG. I am particularly concerned about that amber box designation, where this is the principal mechanism of support for the oil seed complex. It lends itself well to the marketplace, and the rest of the world, if you will, has redefined the process for their best interest, and I am afraid that we are rather a pond in the middle at this point, and I express that concern.

Mr. MORAN. Mr. Reese?

Mr. REESE. With regard to wheat, again, as I pointed out in my testimony, we considered the WTO implications as well as the budget implications in looking at the 2007 farm bill, and I think that while the marketing loan may be still around, its effect as far as wheat is concerned will probably be much diminished, and we are looking more at direct payments and how those could be more of a green box item rather than something like this. It is amber box and it is going to be severely constrictive, if the tea leaves and the prognosticators are correct about what is going to come out of WTO.

Mr. MORAN. Does wheat feel that it is isolated on that issue with other commodities?

Mr. REESE. I think so. When you look at the past history in terms of where we have been able to gain any kind of substance in terms of market support through the marketing loan, at least the 2002 bill, we have been pretty much, as I said earlier, left out in the cold. And part of that was our own doing. We wanted to make sure that that loan price was low enough that we wouldn't have a huge amount of forfeitures as we had before in the previous farm bill. So to the extent that that has happened, I think it has been helpful, but none of us could foresee, I think, a loan price that would be, and over time, substantially out of whack with the cash price that we couldn't possibly gain anything from it. So that is part of our reason for looking at a direct payment that would be substantially larger, and perhaps a more known quantity for the budgeters and the appropriators than a loan program that can be very expensive at times, and it has been in the past. We are hopeful that our colleagues in the other crops can see our position on that point.

Mr. MORAN. Thank you. Mr. O'Connor?

Mr. O'CONNOR. Thank you, Mr. Chairman, for asking that question. First off it is, yes, I would like to see something very similar to what we have with the counter-cyclical payments, and for the extension of an existing farm program. Where they could improve it, I think with this, we need a national energy green reserve with our new energy bill, and I think this would be a great opportunity.

And it also would help with the problem we have right now, when this year, especially in corn, and I am talking when the local market was actually lower than the PCP, that grain, if you could have given the producers an opportunity to forfeit or put it into reserve, one of the two, I think it would go a long way in helping us in our future down the road, and it would be a great addition to the present farm bill. So an extension with a few corrections. Thank you.

Mr. MORAN. Gentlemen, thank you very much for your time and testimony. The subcommittee is very grateful your help in educating us in regard to the posted county price and its effect upon farmers' income and farm policy.

Without objection, the record of today's hearing will remain open for 10 days to receive additional supplementary written responses from witnesses to any question posed by a member of the panel. But at the moment, the hearing on the Subcommittee on General Farm Commodities is now adjourned.

[Whereupon, at 12:05 p.m., the subcommittee was adjourned.]

[Material submitted for inclusion in the record follows:]

STATEMENT OF DEAN SONNENBERG

Mr. Chairman and Members of the Subcommittee, thank you for the invitation to testify today about the procedures the USDA's Farm Service Agency (FSA) uses to establish Posted County Prices (PCPs) for commodities. I am President of the National Sunflower Association (NSA) and am testifying today on behalf of the Association. I am a producer from Fleming, Colorado, where we grow sunflowers, corn, wheat and millet on our farm.

The safety-net provided for sunflowers by the 2002 farm bill, as with the other oilseeds, relies primarily on the Marketing Loan Program. The Direct Payment rate for sunflowers is nominal, and the Counter-Cyclical Payment rate is virtually non-existent. The NSA is happy to report that until this fall, oil sunflower prices—the basis upon which both confection and oil sunflower Loan Deficiency Payments (LDPs) are determined—had been above the loan level. Virtually no sunflower LDP activity took place from 2002 through 2004, and this did contribute to the savings that have been posted by the 2002 farm bill relative to the original Congressional Budget Office score when Congress passed the legislation. Because of these higher prices, NSA did not have reason—until this year—to review the effectiveness of either the terminal market locations or the freight differentials to each county that is used to determine the sunflower PCPs.

However, this past harvest, record yields coupled with a significant increase in sunflower acreage did cause oil sunflower cash prices to decline significantly from those seen in 2004. Conversely, the extremely high diesel fuel prices that we saw this fall caused freight rates to skyrocket. Combined, these two factors did drive the price of oil sunflowers below loan levels in many local markets.

The sunflower PCPs did not initially track the market decline and producers notified the NSA about the growing spread between the PCPs and their local markets. NSA contacted the FSA about the divergence. I would like to take this opportunity to personally thank the FSA for acting swiftly to bring the sunflower PCPs and local market prices back into synch. It's not very often that a government agency moves at such speed and I must say that I was impressed. I understand, and this may be clarified today, that the freight differential to local markets was adjusted by removing a single dominant market that was replaced with a combination of two or three regional market points in order to refine the calculation that determines the local PCPs.

The NSA believes that the higher and more volatile diesel fuel prices seen this fall played a major role in causing the divergence of the sunflower PCPs and the local market price. We also believe that this climate of high energy prices will unfortunately stay with us for some time to come. As a result, the railroads have already devised a baseline energy index formula to reflect moving fuel costs that are then added as a surcharge (and hopefully a discount when warranted) to a base freight rate. For instance, reports of surcharges topping \$500 per rail car over and above the posted freight rate were not uncommon during this past harvest.

Although sunflowers are moved primarily by truck, the higher rail rates dictate all freight rates. With the dynamics of today's energy markets, perhaps the PCPs need to include a similar formula to reflect moving fuel costs. And since surcharges vary by region, such a system would likely be needed to be implemented regionally.

Another factor magnifying the effect rapidly fluctuating freight rates have on the difficulty of establishing accurate PCPs is the changing dynamics of the sunflower market itself. Fewer country deliver points for sunflowers and other specialty crops due to the establishment of 110-car Shuttle train loading points have caused producers to become more involved with direct contracting. And with fewer delivery points today versus 4 years ago, the distance to market has grown considerably, making the freight component of marketing more important than in previous years.

In closing, I want to again thank the Subcommittee for the opportunity to testify on the PCP issue. I would also offer the services of the National Sunflower Association should you need further information on this issue. I will be happy to address any questions you may have.

STATEMENT OF JOHN FLETCHER

Chairman Moran and members of the Subcommittee, I am John Fletcher, general manager of Central Missouri AGRIService Inc., in Marshall, Mo. Our company is a joint venture between a family owned company and two cooperatives. CMAS operates our country elevator, farm supply and feed manufacturing business in west central Missouri. We were established in our present form in 1999. We currently operate six country elevators and two feed mills. I am testifying today on behalf of the National Grain and Feed Association, on whose Country Elevator Committee and Board of Directors I serve.

The NGFA is comprised of 900 grain, feed, processing, exporting and other grain-related companies that operate about 6,000 facilities that handle more than 70 percent of all U.S. grains and oilseeds. The NGFA's membership encompasses all sectors of the industry, including country, terminal and export elevators; feed manufacturers; cash grain and feed merchants; end users of grain and grain products, including processors, flour millers, and livestock and poultry integrators; commodity futures brokers and commission merchants; and allied industries. The NGFA also consists of 35 affiliated state and regional grain and feed associations, as well as two international affiliated associations. The NGFA has strategic alliances with the Pet Food Institute and the Grain Elevator and Processing Society, and has a joint operating and services agreement with the North American Export Grain Association (NAEGA).

The NGFA appreciates the opportunity to testify today to provide our perspective on the U.S. Department of Agriculture's procedures for establishing posted county prices (PCPs) under the marketing assistance loan program. In addition, we want to offer some thoughts in preparation for the 2007 farm bill about what we believe is a need for USDA to update its beneficial interest procedures to be more accommodating of the types of cash grain contracts currently being offered to optimize the potential for producers to earn more income from the marketplace.

POSTED COUNTY PRICES

At the outset, we believe it is important to note that the PCP system was developed by USDA in 1983 in conjunction with the 1983 payment-in-kind program as a method for establishing baseline values for Commodity Credit Corporation-owned inventory and price support loan collateral. Prior to that, USDA had utilized posted elevator prices as a mechanism for establishing values for CCC-owned inventory. During these early years of the PCP system, USDA's goal was to price CCC-owned inventory as close to the market as possible so that it did not undersell or oversell. As a method of approximating grain price values in specific geographic areas, the PCP system performed remarkably well—enabling USDA starting in 1985 to liquidate in an efficient and orderly manner CCC's extensive grain inventory with minimal market disruption.

But during subsequent farm bills—particularly the Federal Agriculture Improvement and Reform Act of 1996—Congress gave USDA different marching orders by adopting a marketing loan program for wheat, feedgrains, soybeans, minor oilseeds, cotton and rice. The laudable goal was to support farm income while allowing grain to be priced at market-clearing levels to avoid another buildup of government-owned stocks that overhang the market and depress farmgate prices. Specifically, the 1996 farm law directed CCC “to the extent possible” to determine and announce an alternative repayment rate, based upon the previous day's market price at appropriate

U.S. terminal markets as determined by CCC, adjusted to reflect quality and location for each commodity. It was this statutory language that USDA used as the rationale for shifting its PCP system to a new, expanded and much more complex role—using it to determine commodity price values as close as possible to the local cash market price in any given area as a key component of an income-transfer mechanism.

In early 1999, the NGFA provided a series of comprehensive recommendations to USDA on ways to improve its system for determining PCPs. Among other things, we recommended that USDA reevaluate the terminal markets it was using, as well as the differentials, to enable PCPs to more accurately reflect local market prices. The NGFA also recommended that USDA revise and update county loan rates for wheat and feed grains to reflect the most recent 12-month average of market prices, and to establish wheat loan rates by class. Further, we recommended that USDA base the LDP loan rate on the county where the commodity is produced, not where delivered or stored, and to permit a 30-day grace period for producers to select their LDP payment to provide additional flexibility and to accommodate logistical concerns.

We commend the Bush administration for utilizing the authority provided in the 2002 farm law to act on several of these recommendations. Most significantly, USDA used congressional intent expressed in report language accompanying the 2002 farm law to update county loan rates and established wheat loan rates by class—the first such adjustments since the 1995 crop, which were based on 1993- and 1994-crop posted county prices that were themselves deemed to be in need of substantial revision to better reflect local market prices.

It was in 2002 that USDA also implemented loan deficiency payment rates on a statewide basis, in response to the 2002 farm law's provision that required USDA when setting loan repayment rates under both the marketing loan and loan deficiency payment program to "minimize discrepancies in marketing loan benefits across state and county boundaries."

So, where do we stand today?

On a national basis, our sense is that USDA generally did a good job this year of monitoring and adjusting its PCPs to keep them roughly in line with cash market prices in local areas during a very difficult harvest situation complicated by large crops, hurricane disruptions and rapidly escalating freight rates. Unlike some previous years, the NGFA's office generally received a lower volume of calls and complaints about PCP anomalies than we had in some previous years.

However, there certainly were some exceptions:

- In mid-October, several NGFA-member country elevators began reporting that sorghum PCPs were no longer reflecting local cash market prices in several areas in Kansas.

- In my home state of Missouri, the gap between PCPs and local elevator cash prices were significantly wider this year during the peak of harvest compared to previous years. For instance, in some areas of Missouri, there was a 20- to 30-cent price differential between county PCP prices and local elevator prices on corn, although local soybean cash prices generally remained above PCPs. However, it appears that much of the differential disappeared in the post-harvest period, which leads us to believe that the spike in harvest transportation costs attributable to extremely tight transportation capacity constraints and the disruption caused by Hurricanes Katrina and Rita played a direct role.

- In the Pacific Northwest, producers and elevators in all counties producing white wheat are facing a problem more attributable to loan rates than PCPs. One of our country elevator members in Washington state reports that the current loan rates for the different wheat classes range from \$2.74 per bushel for soft white wheat to \$3.24 per bushel for hard red winter and \$3.40 per bushel for dark northern spring. But the countercyclical payment rates are based on a compilation of all wheat classes, not individual classes. Recent market prices at that country elevator location have been \$2.96 per bushel for soft white, \$4.05 per bushel for hard red winter and \$4.69 per bushel for dark northern spring, so countercyclical payments are not expected to come into play this year. But the loan rate differentials between these wheat classes are encouraging producers to plant hard red winter to maximize both price support and market benefits, even though the region is not conducive to producing good-quality wheat of that class. Loan rates that are inconsistent with current cash market values cause longer-term market distortions, including misguided planting decisions and impacts on local land values.

How could the current PCP system be improved to more accurately reflect local markets on a consistent basis?

For starters, we believe that dramatically improving the current system would require a substantial increase in the market-price sampling points that USDA con-

tacts daily, to include more localized markets. One of the real challenges in this regard is the trend in markets away from terminal market-based pricing, as many grain movements occur directly from the origin elevator to the customer, bypassing traditional terminal points in the process. This makes local market prices much less predictable unless individual local markets are monitored daily, which would be a huge undertaking. The proliferation of such destination markets as ethanol and biodiesel plants has further complicated USDA's PCP price-monitoring process.

In addition, USDA would need to devise a system that more adequately incorporates changes in transportation costs to reflect actual freight rates for rail, barge and truck or actual freight costs to specific market destinations. It is our view that USDA's terminal market "differentials" relied upon to determine PCPs in local areas are not truly reflecting the freight value changes we are seeing regularly in the market. But these freight rates can fluctuate dramatically, particularly given the impact of carrier-imposed fuel surcharges, which can vary monthly.

The bottom line is that the current system used by USDA—given the human and financial resources allocated to it—is doing about as well as can be expected. As noted previously, to do more to proactively address PCP anomalies that can emerge or occur or when seasonal distortions come into play would require that USDA invest a much higher level of both human and financial resources to monitor local cash prices—a degree of monitoring that we're not sure either the administration or Congress would be willing to undertake.

Currently, USDA relies on producers, grain elevator operators and market observers to provide assistance in alerting the department if PCPs are out-of-line with local cash markets in certain geographic areas. At times, the NGFA itself has been alerted to such PCP anomalies by its members, and has notified USDA headquarters. Generally, our experience has been that these reports are investigated quickly and efficiently by USDA, and that the department is responsive to addressing and correcting significant anomalies that, based upon followup investigation, are shown to warrant adjustment. However, we also have received reports from some NGFA-member companies expressing frustration with the USDA Kansas City Commodity Office's responsiveness after reporting PCP anomalies. To rectify this, the NGFA suggests that USDA establish a more transparent, systematic and better-defined method—perhaps a web-based program—for reporting instances in the future when the LDP payment plus the local cash price is out-of-line with the loan rate. We also believe USDA could be more transparent in explaining the general parameters it uses to investigate PCP anomalies and the factors it uses to determine whether adjustments are warranted. USDA also could improve its follow-up with those who report such anomalies to explain the results of USDA's investigation and the reasons for any adjustments—or lack thereof—that subsequently are made. However, the NGFA does believe that USDA is in the best position to resolve these anomalies in a prudent and expeditious manner.

BENEFICIAL INTEREST

The NGFA also wishes to take this opportunity to encourage USDA to revisit one other component of the marketing assistance loan program that has been problematic in restricting the ability of producers to utilize modern risk-management tools when contracting to sell grains and oilseeds.

I am referring to the requirement that producers retain beneficial interest—that is, title, control and risk of loss—in the commodity to be eligible to receive a loan deficiency payment (LDP) or marketing loan gain.

We commend USDA for earlier this year making several improvements to certain procedural aspects of its beneficial interest rules. In April, USDA's Farm Service Agency issued a notice that clarified that beneficial interest in a commodity is retained until such time as the producer makes a marketing decision with respect to the commodity or relinquishes beneficial interest under the terms and conditions of an applicable written or verbal contract. This helped clarify that producers placing grain in "open storage" at grain elevators did not lose beneficial interest because they still retained the ability to market their crops.

Then in August, USDA developed a new, simplified form that producers can use to indicate their intent to receive an LDP before losing beneficial interest. This new CCC-633 EZ form enables producers to indicate once each crop year of their intention to receive an LDP. This form then allows the producer to subsequently submit a request for the LDP at any time during the marketing assistance loan or LDP availability period for the given commodity. The LDP rate for the affected commodity is based on the earlier of: (1) the date the producer requests the payment; or (2) the date beneficial interest is or was lost.

While both of these steps have improved the “mechanics” of the marketing assistance loan process with respect to beneficial interest, they have not resolved the major underlying problem. And that problem is that the concept of beneficial interest is out-of-kilter with various kinds of new-generation cash grain contracts that offer producers opportunities to maximize market returns. Specifically, USDA has ruled that certain types of advance sales contracts, contracts-to-sell, price-later contracts and contracts for future delivery of grain violate the “beneficial interest” rules because these contracts give the buyer an interest in the commodity at the time specified in the contract or at a time implied by law.

For example, USDA has stated that: “If the producer has or will receive a payment in return for a sales contract, “beneficial interest” is lost when the payment is made or when the producer loses control, risk of loss, or title to the commodity.” In a credit-sale contract, such as a delayed-price or deferred-payment contract, legal title and physical possession of the commodity have transferred. Thus, the producer has lost “beneficial interest” for the quantity sold under such contracts. ” [NGFA Government and Grain, September 30, 2004.]

The NGFA respectfully submits that there is something amiss when a government farm program that is designed to avert forfeitures, encourage stocks to enter market channels, and maximize farm income has the unintended and perverse effect of limiting the marketing options available to producers.

The NGFA believes USDA has the legal authority under current statutory language to revisit the beneficial interest issue to bring it more into line with the current market environment and the type of producer marketing contracts currently being offered, while still preserving proper safeguards to prevent fraud, abuse or “price speculation ”by producers attempting to maximize LDP benefits. Allowing producers to enter into a full array of cash grain contracts earlier in the crop year could improve their ability to generate additional revenue from the market and further strengthen the producer safety net.

If USDA’s analysis reveals that it does not believe it has sufficient statutory authority to modify its current interpretation of the beneficial interest rules, the NGFA may seek Congress’ help in revising the statute as part of the 2007 farm bill.

Mr. Chairman, that concludes my statement. I would be pleased to respond to any questions you or other members of the subcommittee may have.

Introduction

Mr. Chairman and members of the committee, thank you for the opportunity to come before you today to discuss posted county prices (PCPs). Joining me today is Mike Yost, Farm Service Agency, Associate Administrator for Programs and Bert Farrish, Deputy Administrator for Commodity Operations.

This committee has asked the Department of Agriculture to meet two objectives in this hearing: (1) to assess the technical procedures of USDA's establishment of PCPs; and (2) to explain the Department's plan to continue to improve accuracy in this system.

My testimony today will answer four questions. First, what is the legislative history of PCPs that brings us to where we are today? Second, what are the formulas and the technical procedures for calculating PCPs? Third, what are the underlying issues of PCPs that have some producers frustrated with this system? And fourth, what are some of the components of the plan to improve the operation of the PCP system?

PCPs affect the business of growing and marketing 17 different commodities. USDA sets more than 88,000 PCPs each day, five days a week. Those prices cover corn, barley, oats, soybeans, grain sorghum, canola, crambe, rapeseed, flaxseed, sesame seed, sunflower seed, safflower, mustard seed, small chickpeas, lentils, dry peas and five different classes of wheat. The PCP system is a very hands-on process. Farm Service Agency (FSA) employees in Kansas City and here in Washington analyze prices from the Data Transmission Network (DTN), the Agricultural Marketing Service (AMS) and commodity exchange activity daily. In addition, FSA contacts market representatives across the nation about 500 times each day. The information we gather today is the basis for PCPs tomorrow.

I. Legislative History

The marketing assistance loan program was amended by Congress in the Farm Security and Rural Investment Act of 2002 (2002 Act), but has origins dating back to 1983.

The origin of the PCP system began with the payment-in-kind (PIK) program in 1983. At the time, USDA needed a way to value corn inventory controlled by the Commodity Credit Corporation (CCC).

The Food Security Act of 1985 (1985 Act) was the first "legislative" step toward creating PCPs. The 1985 Act amended the Agricultural Act of 1949 (1949 Act) requiring the Secretary to offer marketing assistance loans and loan deficiency payments (LDPs) beginning with the 1985-1990 crops of rice and the 1986-1990 crops of upland cotton and feed grains. Marketing assistance loans and LDPs were discretionary for the 1986-1990 crops of wheat, feed grains and sorghum. Furthermore, it provided for the issuance of commodity certificates for wheat, feed grains, upland cotton and rice (program crops).

Congress further amended the 1949 Act with the Food, Agriculture, Conservation and Trade Act of 1990 which required the Secretary to extend marketing assistance loans and LDPs for the 1991-1995 crops of minor oilseeds, upland cotton and rice. The 1990 Act required the Secretary to offer marketing assistance loans and LDPs through the 1995 crops for covered commodities.

The Federal Agriculture Improvement and Reform Act of 1996 (1996 Act) mandated marketing assistance loans and LDPs for the 1996-2002 crop years of rice, upland cotton, wheat, feed grains, soybeans, and oilseeds.

Section 1204 of the 2002 Act continued the authorization of marketing assistance loans and LDPs and permits a producer to repay a marketing assistance loan for a loan commodity (other than upland cotton, rice and extra long staple cotton) at a rate that is the lesser of either:

- The loan rate established for the commodity, plus interest;
- or,
- A rate the Secretary determines will...
 - minimize potential loan forfeitures;
 - minimize the accumulation of stocks by the government;
 - minimize the government's cost for storing the commodity;
 - allow the commodity to be marketed freely and competitively both domestically and internationally; and
 - minimize discrepancies in marketing loan benefits across state boundaries and county boundaries.

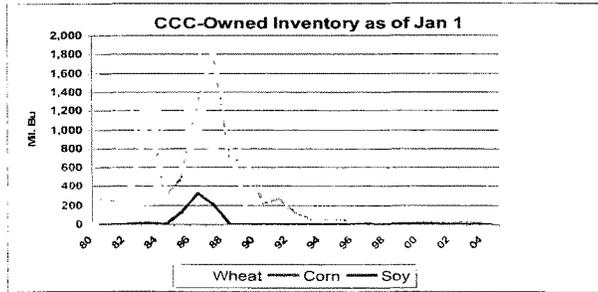
Peanuts are now covered by marketing assistance loans and LDPs. LDPs are available as well for cotton and rice as part of the loan system but with different LDP language.

Determining a rate that simultaneously meets these statutory objectives will not guarantee that PCPs will generate an LDP plus the local cash price that equals county loan rates. There is a significant misconception that takes place pertaining to PCPs. Producers often assume that their LDP plus the local cash market price must equal their county loan rate. However, the 2002 Act does not guarantee this. The LDP aspect of the loan program is designed to avoid forfeitures. Utilizing the loan provision is the only way for the producer to guarantee receipt of the loan rate for the applicable crop. The loan is the benefit, not the LDP.

Historically, Congress has asked the Department of Agriculture to minimize forfeitures. It is for good cause. Forfeited commodities are a burden on taxpayers and a challenge for the Department to manage. The current system does, in fact, minimize forfeitures. *Illustrations 1 and 2* on the following page demonstrate a dramatic drop in commodity ownership during the late 1980s and, in recent years under marketing assistance loans, the quantity of wheat, soybeans and feed grains forfeited to the CCC has remained below one percent of production

Illustration 1

CCC-Owned Inventory as of January 1: 1980 – 2004



This table illustrates the change in CCC commodity ownership (1980-2004) by crop, year, and amount.

Illustration 2

	Wheat (mil. Bu.)	Corn (mil. Bu.)	Soybeans (mil. Bu.)
1980	203	254	0.5
'81	191	248	0.5
'82	185	429	14
'83	376	1230	23
'84	419	296	3
'85	557	477	124
'86	987	1265	333
'87	883	1843	212
'88	805	679	0.5
'89	161	676	1
1990	145	214	0
'91	161	265	0.5
'92	165	125	0
'93	168	54	0.5
'94	144	44	0.5
'95	141	42	0.5
'96	96	30	0
'97	93	2	0
'98	107	15	3
'99	104	26	7
2000	109	36	10
'01	118	24	4
'02	93	18	3
'03	78	16	0.5
'04	62	1	0

Illustration 3 depicts the successful management of forfeited grains from 1999 to 2004.

Illustration 3

Crop Loan Forfeitures 1999-2004

Commodity	Crop Year	Estimated Production (NASS)	Quantity Forfeited to CCC	Percent of Production Forfeited
Corn (bu.) *				
	1999	9,430,612,000	31,696,419	0.3361%
	2000	9,915,051,000	26,596,167	0.2682%
	2001	9,502,580,000	17,027	0.0002%
	2002	8,966,787,000	1,892,953	0.0211%
	2003	10,089,222,000	1,037,721	0.0103%
	2004	11,807,217,000	16,741,632	0.1418%
Soybeans (bu.)				
	1999	2,653,758,000	11,479,156	0.4326%
	2000	2,757,810,000	5,704,769	0.2069%
	2001	2,890,682,000	54,506	0.0019%
	2002	2,756,147,000	205,169	0.0074%
	2003	2,453,665,000	122,168	0.0050%
	2004	3,123,686,000	413,485	0.0132%
Wheat (bu.)				
	1999	2,295,560,000	29,967,120	1.3054%
	2000	2,228,160,000	12,749,123	0.5722%
	2001	1,947,453,000	442,849	0.0227%
	2002	1,605,878,000	1,507,263	0.0939%
	2003	2,344,760,000	2,480,904	0.1058%
	2004	2,158,245,000	7,007,622	0.3247%
Barley (bu.)				
	1999	271,996,000	1,341,092	0.4931%
	2000	317,804,000	670,937	0.2111%
	2001	248,329,000	0	0.0000%
	2002	226,906,000	0	0.0000%
	2003	278,283,000	239,748	0.0862%
	2004	279,743,000	198,713	0.0710%
Sorghum (cwt.) *				
	1999	595,166,000	446,079	0.0750%
	2000	470,526,000	200,165	0.0425%
	2001	514,040,000	0	0.0000%
	2002	360,713,000	95,134	0.0264%
	2003	411,237,000	33,295	0.0081%
	2004	454,899,000	158,287	0.0348%

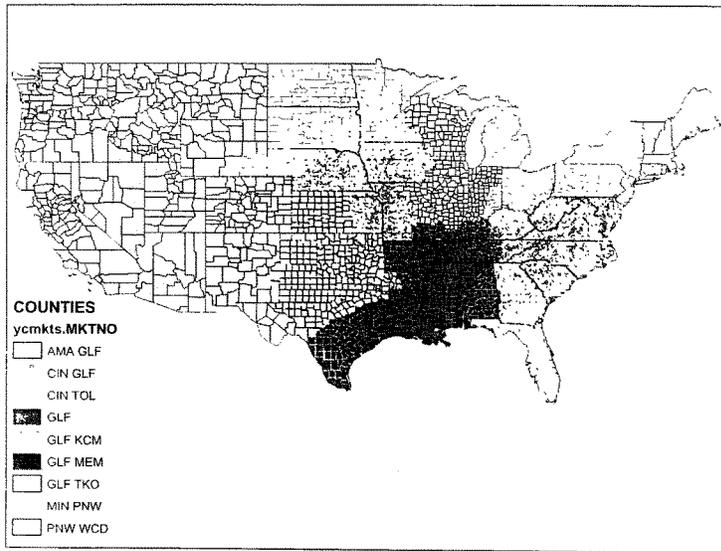
* Excludes Silage.

II. Technical Procedures for Calculating PCPs

Overview – The PCP is a proxy for the cash value of a commodity. It is determined by taking terminal market prices then adjusting for a value reflecting historical price relationships between local and terminal market prices (county differential) and then adding or subtracting a value to minimize differences across state and county boundaries and reflect localized current year market anomalies (terminal adjustment).

The **terminal price (TP)** is the average cash offerings for a commodity in a *specified* terminal market on a *particular* day. USDA employees analyze DTN, AMS and commodity exchange activity daily and acquire data on cash offers for *that* commodity through personal daily contacts with commodity buyers in *that* market. For corn, there are 10 terminal markets used by USDA in the United States. *Illustration 4* depicts the corn terminal market combinations. Counties are assigned at least one terminal for each commodity (in most cases two terminals are assigned).

Illustration 4
Corn Terminal Market Combinations



The **county differential** (CD) is an assigned value based on historical price relationships between local county market prices and assigned terminal prices for *that* commodity. The assigned county differential reflects price differences between local county and terminal market prices.

The **terminal adjustment** (TA) is a value assigned by USDA employees and is used to minimize marketing assistance loan benefit differences between state and county boundaries and to reflect current market relationships. Other issues reflecting localized supply and demand factors may also affect the amount of *that* terminal adjustment.

The PCP Formula – Using the abbreviations offered for each component above, the formula is simply: $TP \pm CD \pm TA = PCP$. PCP calculations that feature two terminal prices use the higher-of-the-two-adjusted-prices (see *Illustration 5* below).

Implementing the PCP system is indeed complex. When terminal markets and county prices vary significantly because of differing supply and demand factors, the resulting impact can be a variance in PCPs and marketing assistance loan benefits between neighboring counties.

Corn is the dominant commodity covered by PCPs. In *Illustration 5*, two of the 10 terminal markets in the United States are used to calculate the PCP for a hypothetical producer in Christian County, Illinois in the following illustration:

Illustration 5

PCP Calculation Example		
Christian County, Illinois - Corn		
Terminal	GLF (Gulf Coast)	TKO (Decatur, IL)
Terminal Price	\$2.41 per bushel	\$2.08 per bushel
County Differential	- 0.46 per bushel	- 0.17 per bushel
Terminal Adjustment	- 0.43 per bushel	- 0.25 per bushel
	\$1.52 per bushel	\$1.66 per bushel C
Posted County Price		\$1.66 (PCP)

The PCP is set at the higher of the two adjusted terminal market prices. The concept underlying this higher-of-the-two-adjusted-prices approach is that the higher of the two terminal prices will be reflective of the price that producers receive for their commodity.

Specialized commodities, such as chickpeas and lentils, have fewer terminal markets. USDA uses only one terminal market when calculating the PCP for those commodities. The two PCP calculation examples on the next page are for different commodities; hard red winter wheat in Tripp County, South Dakota (*Illustration 6*), and grain sorghum in Cloud County, Kansas (*Illustration 7*):

Illustration 6

PCP Calculation Example		
Tripp County, South Dakota – Hard Red Winter Wheat		
Terminal	PNW (Pacific Northwest)	MIN (Minnesota)
Terminal Price	\$4.56 per bushel	\$4.38 per bushel
County Differential	- 1.07 per bushel	- 0.72 per bushel
Terminal Adjustment	- 0.32 per bushel	- 0.37 per bushel
	\$3.17 per bushel	\$3.29 per bushel C
Posted County Price		\$3.29 (PCP)

Illustration 7

PCP Calculation Example		
Cloud County, Kansas – Grain Sorghum		
Terminal	AMA (Amarillo, TX)	GLF (Gulf Coast)
Terminal Price	\$3.13 per hundredweight	\$4.17 per hundredweight
County Differential	- 0.81 per hundredweight	- 1.04 per hundredweight
Terminal Adjustment	+0.03 per hundredweight	- 0.65 per hundredweight
	\$2.35 per hundredweight	\$2.48 per hundredweight
Posted County Price		\$2.48 (PCP)

Concerns over USDA's PCP system occur when program benefits differ widely in adjacent or neighboring counties, or when PCPs exceed cash market prices and when the local cash price plus LDP is below the loan rate.

Counties that are adjacent to those in different terminal markets, or counties where the two terminal markets used to calculate their PCPs are different, are more likely to reflect discernable differences. However, differences are not limited to border issues.

Illustration 8 on the following page demonstrates how within one county there is considerable variation in local cash prices.

Illustration 8

Mower County, Minnesota		
November 30, 2005		
Location – Cash	Corn	Soybeans
Grand Meadow	\$1.38	\$5.02
Sargeant	\$1.35	\$5.06
Dexter	\$1.40	\$4.99
LeRoy – Coop	\$1.38	\$5.04
LeRoy – Koch	\$1.29	\$4.95
PCP	\$1.43	\$5.11

The cash market for corn in Mower County varied by \$0.11 on November 30. In the town of LeRoy, a village of 900 people 35 miles south of Rochester, Minn., there was a price difference of \$0.09 between the two elevators that day. The same was true for soybeans.

Price quotes from different elevators within a specific county commonly vary for several reasons. Elevator facilities with truck, barge, and rail capabilities generally offer higher bids for commodities than those with limited services, choosing to move commodities using the least expensive option. With respect to rail services, companies with unit train (100+ cars) capabilities are generally in a position to offer a higher cash price due to volume discounts. Another reason that a particular location may quote higher or lower prices than other area elevators is based on their current demand for the commodity. For example, a company which has satisfied all delivery contracts is not compelled to offer high prices. Conversely, a company that is short in covering upcoming delivery obligations may be pressed to offer higher cash prices than other area elevators.

III. The Underlying Issues of the Posted County Prices System

Loan Deficiency Payments and Non-recourse Marketing Assistance Loans – Utilizing the loan provision is the only way for the producer to guarantee receipt of the loan rate for the applicable crop. USDA's CCC makes available non-recourse marketing assistance loans for certain commodities. The national loan rate for each commodity is set by statute. Loan rates for each county are determined once per year and all county loan rates for a particular commodity must balance back to the statutory national rate.

Once a loan rate is set for a year, it does not change. Loan rates are updated each year to reflect PCPs, production, and adjustments to differentials. There are many potential reasons for adjusting these differentials, including: (1) actual cash prices; (2) changes in production levels; (3) changes in marketing patterns such as the emergence of the ethanol industry; and (4) changes in transportation costs.

Marketing assistance loans provide interim financing to producers at harvest time to help meet cash flow needs without that producer being required to sell crops when market prices are typically at harvest-time lows.

Allowing producers to store newly harvested commodities enables them to market their commodities in a more orderly manner throughout the year.

Marketing assistance loans for covered commodities are *non-recourse* because the commodity is pledged as loan collateral and producers have the option of either delivering the pledged collateral to CCC as full satisfaction of the loan obligation when the loan matures or settling up in cash. Marketing loan repayment provisions specify, under certain circumstances, that producers may repay loans at less than principal plus accrued interest and other charges.

Alternatively, LDP provisions specify that, in lieu of obtaining a loan, producers may be eligible for an LDP.

Marketing assistance loan repayment and LDP provisions are intended to accomplish five objectives: (1) minimize potential loan forfeitures; (2) minimize accumulation of CCC-owned stocks; (3) minimize costs incurred by the government in storing the commodity; (4) allow the commodity to be marketed freely and competitively; and (5) minimize discrepancies in marketing loan benefits across state and county boundaries. Accumulating CCC-owned stocks can result in significant storage costs to taxpayers.

The challenge in setting PCPs is establishing PCPs reflective of local cash prices while minimizing the resulting discrepancies in marketing loan benefits. If PCPs in each county are reflective of local cash prices, differences in marketing loan benefits may naturally widen between state and county boundaries, contrary to statutory provisions. Conversely, if PCPs are established to ensure that differences in marketing loan benefits are held to a minimum, PCPs will not reflect local cash prices. When PCPs are adjusted to accurately reflect local cash prices, but the adjustments are limited geographically, then marketing loan benefit rift lines occur. Producers have been known to chase the higher benefit with the unintended consequence of drawing commodities to an area that, based on market conditions, does not need or want the excess commodity. *Illustration 9* shows the average gain per bushel of 2005-crop corn through the end of November. LDPs and marketing assistance loan gains through the end of November amounted to \$3.1 billion on 7.0 billion bushels of corn, or \$0.45 per bushel.

Illustration 9

2005 Crop Corn		
(as of November 30, 2005)		
Benefit	Quantity	Amount
LDPs	6.79 billion	\$3.035 billion
Marketing Loan Gains	0.23 billion	\$0.105 billion
TOTAL	7.02 billion	\$3.140 billion
Average Gain = \$0.45 per bushel		

The emphasis on the statutory requirement to minimize marketing assistance loan benefits across state and county boundaries has created equal benefits within specific geopolitical boundaries such as within a state. With a dynamic market place overlaying these static values, inaccuracies in the PCPs occur. An example of this was the differences in cash prices between western and eastern Iowa this last fall. Eastern Iowa suffered from drought conditions and then the impacts along the river of Hurricane Katrina causing lower cash prices. Western Iowa prices were not impacted in the same manner. Under the current PCP system all producers in Iowa received equal loan and LDP benefits on any given day.

Loan Rates – Another challenge occurs from using PCPs to determine county loan rates for subsequent crop years. Loan rates are established for each commodity and county on an annual basis and, conversely, market prices fluctuate on a daily basis to reflect local market conditions. Adjustments to lower PCPs in order to increase marketing loan benefits will result in lowering the county's loan rate in subsequent crop years. It is important to remember that an adjustment to a loan rate is a zero-sum game as county rates must balance back to the national level as set in the law.

As stated previously, the LDP plus the cash market price may not equal the loan rate. The 2002 Act does not guarantee this.

The 2002 Act provides that marketing assistance loans may be repaid at the lesser of the commodity loan rate plus interest, or at a rate determined by the Secretary of Agriculture that will minimize potential loan forfeitures and government accumulation of stocks and storage costs. The provision further requires the repayment rate to allow the commodity produced in the United States to be marketed freely and competitively, both domestically and internationally, and minimize discrepancies in marketing loan benefits across state boundaries and across county boundaries.

Unique Challenges in 2005 – Unlike previous years, PCPs have been affected by four key situations in 2005: (1) some of the typical advantages of barge rates over rail eroded late last summer because of lower water levels in the Upper Mississippi River system caused by drought in the Corn Belt states; (2) in the Mississippi and Texas Gulf regions, the "one-two punch" of Hurricane Katrina followed by Rita affected both rail and waterway transportation negatively; (3) energy and fertilizer prices soared in the past year along with the prices of crude oil and natural gas; and (4) significantly higher 2005-crop yields, coupled with carryovers from record 2004-crops, contributed to lower export demands.

IV. Components of the Plan to Improve the PCP System

The PCP system has been in place for many years and has undergone several in-depth reviews. Every harvest season, FSA receives calls and correspondence regarding the accuracy of the PCPs or the discrepancies in marketing loan benefits across state and county boundaries. FSA continues to look for improvements or new methodologies to use in setting the repayment rate for marketing assistance loans. FSA has initiated a

review of the current policies and processes that compose the PCP system. This review will examine the basic assumptions regarding equal marketing assistance loan benefits and LDPs within a specific geographic or geopolitical area and the commonly held belief that the LDP plus the local cash price should equal the county loan rate. Further, emerging market dynamics like ethanol, fuel costs, and rail and barge capacity must be re-examined. All aspects of price discovery, including collection and reporting processes, will be studied. FSA intends to complete this review before the start of the 2006 marketing year. Ethanol is one impact worthy of further exploration.

Ethanol – The market impact of ethanol production on corn PCPs has become more apparent each year. FSA initiated price discovery efforts with ethanol producers in the 2004 crop year and has worked with industry experts to gain knowledge of the ethanol industry, pricing mechanisms, and contracting structures. In both 2004 and 2005, as part of the county loan rate review, county differentials were adjusted to reflect ethanol plant locations and market influences. FSA continues to study this strong emerging market force and to determine the optimal method to reflect its impact on the PCPs either through new terminal markets or additional differential adjustments.

Conclusions

There are many details and factors that influence 88,000 PCPs every day. We strive to keep our focus on the process, because the process helps us achieve a stable and consistent national system. Each day, the Kansas City Commodity Office (KCCO) obtains cash market prices from numerous terminal markets. Employees gather information on commodities such as corn, wheat, barley, oats, grain sorghum and soybeans. They use closing spot cash prices to determine the CCC terminal market prices that will be effective the next business day, which in effect, puts the PCPs one market day behind cash prices.

PCPs for each county (approximately 3,000) and for each commodity are determined daily. The process starts with terminal market prices, which are averages obtained directly from the industry. KCCO adjusts terminal market prices to create PCPs by applying county differentials that represent market influences, freight charges and other factors in order to reasonably simulate local conditions and accomplish the objectives established in the statute. Then KCCO considers price data from other market sources, such as AMS, DTN, and commodity exchanges, as well as other reliable information in the marketplace. Those factors figure into the adjustments made for each county.

KCCO completes the same process for other oilseeds and pulse crops with PCPs subject to change on a weekly basis. Employees also monitor relationships between PCPs and cash prices on a daily basis through industry surveys at more than 500 locations.

Despite the rigors set up for constant marketplace surveillance, it must be emphasized that the system is national in scope and therefore, vulnerable to local conditions. When PCPs do not accurately reflect local cash prices, USDA hears from producers. KCCO then searches for additional data from a variety of sources to verify whether these

concerns are valid. If it appears that they are, USDA makes temporary adjustments that are determined to be appropriate with the objective of obtaining a PCP that better reflects the real cash market, and minimizes LDP spreads across state and county boundaries.

To accomplish the second objective – minimize LDP spreads – KCCO makes terminal market adjustments even though PCPs may already represent cash prices. A case in point occurred in central Illinois last year, a record setting year for corn and soybean production. USDA adjusted the TKO (Track Origin, Decatur, Illinois) terminal market during the week of September 20 to modify PCPs to more accurately reflect cash prices. To minimize the resulting discrepancies across state and county boundaries, KCCO also made adjustments to the dominant terminal market in Iowa and surrounding states. Without these adjustments, there would have been an eight-cent (\$0.08) LDP difference between Illinois and Iowa.

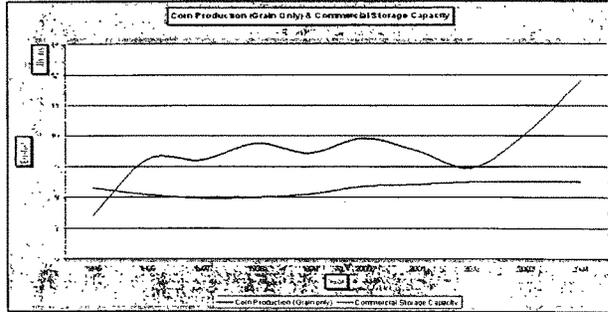
The net result of these adjustments was that PCPs in the surrounding states were substantially lower than cash market prices. It caused concern among state offices, producers and elevators. Calls received indicated that PCPs were *under* local cash prices ranging from nine cents (\$0.09) to 45 cents (\$0.45). However, LDP rates remained fairly consistent across state and county boundaries.

When PCPs fall out of line with cash prices in a county or region and it appears that the discrepancy may last, KCCO makes permanent adjustments to differentials for applicable commodities and counties.

Setting PCPs for the 2004 and 2005 crops has been challenging. Still, the overall program is meeting the mission prescribed by Congress. It minimizes loan forfeitures, minimizes the accumulation of stocks by the government, minimizes the government's cost for storing commodities, allows the commodity to be marketed freely and competitively, and minimizes discrepancies in marketing loan benefits across state and county boundaries.

If you look at our final illustration, you will see another potential challenge for the PCP system. The figure shows the rapid growth in corn production and the lack of growth in storage capacity since 2002. As storage capacity becomes increasingly tight in some areas relative to others, local market prices may deviate substantially across regions. We will be monitoring this development along with all the others to make sure that we continue to meet the objectives laid out in the legislation.

Illustration 10



At USDA, we believe we are meeting the legislative objectives of the marketing assistance loan program. Are our efforts without flaws? No. But the flaws usually surface when outside influences affect farming, such as natural disasters and high energy prices. The two most recent extraordinarily large crops have had a significant impact on administering the PCP system. We are aware of these risks and know how to make quick and successful adjustments to keep the program on task.



National Association of Wheat Growers

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**Statement of Sherman J. Reese
President of the National Association of Wheat Growers
before the
House Committee on Agriculture
Subcommittee on General Farm Commodities
and Risk Management
December 14, 2005**

Mr. Chairman and Members of this committee, my name is Sherman Reese. I am currently serving as the President of the National Association of Wheat Growers, and am an active wheat farmer from Echo, Oregon.

Thank you for this opportunity to be here today. I look forward to sharing our thoughts about the loan program as it is currently structured, and some unintended impacts it is creating.

Wheat growers as a whole have not been able to make use of the loan program as established under the 2002 Farm Bill. Part of this is the result of persistent droughts in wheat states, and with no crop to sell there is no loan program benefit, and part of it is a perception by producers that other crops have a more attractive safety net or are otherwise more competitive. We believe there are several issues that need to be addressed if the loan program is to be retained in the next farm bill, but I would like to spend my time today discussing discrepancies in posted county prices and their effects on Loan Deficiency Payments, and touching on a particular issue in class rate differentials.

The methods used by USDA to calculate posted county prices have an arbitrary and unpredictable effect on Loan Deficiency Payment rates.

Posted county prices are calculated by subtracting the county differential from the appropriate U.S. terminal market price. County differential reflects the cost of moving the commodity from that county to the terminal market, plus additional factors such as local demand and local markets.

These additional factors appear to be subjective values with no established formula, giving rise to discrepancies between the posted county price and the actual cash price.

These discrepancies are exhibited through posted county price values both far above and far below actual cash price for a county.

Recent swings in these values ranged from 19 cents under cash price to 18 cents above during the period of May 17 to August 11, 2005 for winter wheat in Choteau County, Montana. Spring wheat posted county price ranged from 16 cents under to 72 cents over during that same time.

These discrepancies are unacceptable, not only because of the inconsistency, but for the possible failure of a safety net for farmers who rely on the Loan Deficiency Payments when markets fail to provide a price that covers the cost of production.

A possible remedy is for USDA Farm Service Agency to periodically canvass county grain elevators to determine an average local cash price in order to adjust the differential so the posted county price would more closely reflect actual cash price.

I should also point out that a few years ago, USDA had some large differentials between adjacent counties for loan rates. In my area, there were two adjacent counties with 12 cents difference in county loan rates. USDA has been responsive to our requests to smooth these out, and while there may still be some issues out there, they have largely been resolved and we thank the Department for doing so.

Let me touch on some results of USDA's decision to separate wheat loan rates by class of wheat. We were not aware of this proposal during negotiations for the 2002 legislation, so the Administration's decision to separate them by class came as a bit of a surprise for NAWG and its member states. Everyone knew there would be adjustments, and some of those have had different regional impacts; this distribution of impacts is very difficult for a national organization with members in all regions and classes to address.

NAWG supports the principle established by the 21st Century Commission which was chartered in the 2002 law: that the purpose of federal agricultural policy is to "provide a safety net under farm income with minimal market distortion." This principle guides our preparation of proposals for the 2007 Farm Bill, and it guides our response to the question of regional loan rates. If Administration decisions are causing growers to shift from one class of wheat to another, when the market is sending different signals, then federal policies need to be changed. If, however, class loan rates are following true market signals that are accurately conveyed and not distorted through arbitrary or subjective adjustment factors, then the program is working as advertised and is consistent with the 21st Century Commission principle.

We have received complaints from some soft white wheat producers about the differential in loan rates between hard red and soft white wheat in the Pacific Northwest. They contend that USDA decisions and adjustment factors result in a lower loan rate for soft white than would otherwise result, and that in response farmers are shifting from soft white to hard red. Our response to those states has been consistent with what I just said: if the market is driving those differences, free from subjective interference, then the program is working properly. If there are subjective or arbitrary adjustment factors or policy decisions that are driving planting decisions, it is not working properly and NAWG will support getting it fixed.

Therefore, we suggest that the Subcommittee conduct a thorough review – confidential if necessary – of the exact formula and methodologies for determining adjustment factors by

USDA to satisfy the question of whether subjective adjustments are made. You should ascertain whether the loan rates for those classes of wheat are truly following market signals, or whether there is interference in those signals. NAWG would be happy to participate in that review. Once that information is known, we'll all have a better idea of appropriate remedies, should they be necessary. In conclusion, I would like to reiterate our belief that the loan program has not worked efficiently for wheat producers, and has caused wheat producers to miss out on a major part of the farm safety net.

NAWG members understand that due to our commitments within the World Trade Organization and tight budget situations in the federal government, we need to start looking towards more green box programs for the next farm bill. We should keep the 21st Century Commission's principle in mind, and provide support through less market-distorting mechanisms.

NAWG members have already begun putting together potential proposals for the 2007 farm bill that will allow wheat producers to use more of the farm safety net while keeping planting flexibility, and keeping our WTO commitments.

I look forward to sharing these proposals with this committee, and working with you as you begin drafting legislation for the 2007 farm bill.

I am ready to answer any questions about my testimony today.

STATEMENT OF MR. MICHAEL O'CONNOR

**MEMBER, SOUTH DAKOTA FARMERS UNION
ON BEHALF OF NATIONAL FARMERS UNION**

**BEFORE THE U.S. HOUSE AGRICULTURE SUBCOMMITTEE
ON GENERAL FARM COMMODITIES AND RISK MANAGEMENT**

**REVIEW OF TECHNICAL PROCEDURES OF USDA'S ESTABLISHMENT OF
POSTED COUNTY PRICES**

DECEMBER 14, 2005

Thank you, Chairman Moran and Ranking Member Etheridge, for holding this hearing and providing me the opportunity to testify before your subcommittee concerning the technical procedures of the United States Department of Agriculture's (USDA) establishment of posted county prices. My name is Mike O'Connor; I am a member of the South Dakota Farmers Union and am here to testify on behalf of the National Farmers Union (NFU). I am an independent family farmer from southeastern South Dakota, raising cattle, corn and soybeans. I served as the South Dakota Farm Service Agency (FSA) executive director from 1993-2001, and as the Jerauld county FSA director from 2001-2003.

If there is one thing independent-minded farmers can agree upon, it is the confusion and complexity of posted county price (PCP) setting. The process is something very few can clearly explain or comprehend. A consistent theme among producers is that the system is inconsistent and unreliable. As a producer and former FSA state director, I have had the unique opportunity to witness the complexities of PCPs from all sides. Producers get easily frustrated, because they try very hard to figure out how the system works, and by the time they think they have it figured out, the PCP will do something opposite what it "should."

The objective of posted county prices is to determine a value as close as possible to the local cash market price in any given area. Each county has a determined posted county price based on the prior days market close for a particular commodity. My home county, Union county in South Dakota, bases its PCP off the higher of two terminal market points, Minnesota and Portland, and the additional differentials and discounts. More often than not, the PCP is out of touch with what the local cash market price is doing.

One out of every three rows of corn is processed into ethanol in South Dakota. Because loan rates are set on the distance from a market, the value-added markets such as ethanol plants are not taken into account. The price for corn sold to an ethanol plant follows the Chicago Board of Trade (CBOT) price. Most producers understand the workings of the

market based on the CBOT, which establishes the market followed by all forms of grain marketing my region.

Often, the PCP will follow the CBOT, but not always. There are occasions when the CBOT closed higher or lower and the following days PCP was just the opposite or not the same fluctuation. This is very frustrating for many producers who want to understand the PCP setting process and be better marketers of their commodities.

Differentials

One of the biggest problems producers see with their PCP is inconsistent differentials. The transportation differential this year has undoubtedly been compounded by skyrocketing energy prices. Energy surcharges tacked on by transportation entities, whether rail, ground or barge, not only are paid directly out-of-pocket by producers, but also impact the degree of differentials used to establish a posted county price.

Evidently differentials can be altered to fit a situation, thus being reactionary in nature. For example, the 2004 corn crop PCP was actually higher than the local markets at the end of the summer in 2004. USDA did not want forfeited market loans and was able to make adjustments and add differentials into the PCP rate. This resulted in many of the buyback rates across county lines and state lines being significantly apart. There seems to be a "black hole" with other deductions and no explanation; increasing transparency in establishing differentials would go a long way in understanding how and why a PCP rate is where it is.

Some have said in the past that PCP establishing is a "closely guarded USDA secret," to prevent market manipulation. It seems to me, that it is hard for producers to manipulate the market using day-old markets to establish the PCP rate.

County-to-County/Contiguous States

At times, the PCP between counties is different with no explanation and PCPs between neighboring states are sometimes off. Let me give you an example by looking at the corn buy-back rate in four counties in my area, two in South Dakota and two in neighboring Iowa. From July 1, 2005, through September 30, 2005, South Dakota had a higher buy-back rate 29 of the days at an average of 3.5 cents over Iowa's. Iowa had a higher buy-back rate 16 of those days at an average of 2.06 cents higher than South Dakota's. For the remaining 19 days, South Dakota and Iowa had the same buy-back rate, or no rate was available.

There was a month-long stretch from late August to September where the two counties within the respective states did not have the same the rate. During that month, there are 20 days of data. Here is what happened:

In South Dakota in the 20-day block, 14 of those days, Union and Clay counties had the same rate.

- Two of the 20, Union county had a higher rate at an average of 1.5 cents.

- Four of the 20, Clay county had a higher rate at an average of 4 cents. The largest gap between them in the 20 days was 5 cents

During the same 20-day period in Iowa, Plymouth county had a higher buy-back rate than Sioux county, at an average of 2.2 cents with the largest gap being 3 cents.

Date	Union (SD)	Clay (SD)	Sioux (IA)	Plymouth (IA)
8/24/2005	0.25	0.25	0.24	0.26
8/25/2005	0.32	0.37	0.26	0.28
8/26/2005	0.31	0.36	0.28	0.3
8/29/2005	0.36	0.4	0.3	0.32
8/30/2005	0.4	0.38	0.3	0.33
8/31/2005	0.39	0.38	0.31	0.34
9/1/2005	0.38	0.4	0.39	0.42
9/2/2005	0.29	0.29	0.29	0.32
9/6/2005	0.38	0.38	0.35	0.37
9/7/2005	0.34	0.34	0.31	0.33
9/8/2005	0.42	0.42	0.39	0.41
9/9/2005	0.44	0.44	0.41	0.43
9/12/2005	0.38	0.38	0.37	0.39
9/13/2005	0.4	0.4	0.37	0.39
9/14/2005	0.41	0.41	0.38	0.4
9/15/2005	0.43	0.43	0.4	0.42
9/16/2005	0.44	0.44	0.42	0.44
9/19/2005	0.45	0.45	0.42	0.44
9/20/2005	0.45	0.45	0.42	0.44
9/21/2005	0.44	0.44	0.41	0.43

Source: USDA/FSA buy-back rates on 2004 corn

Solutions

There is no quick and easy solution that would be perceived as fair to all producers. Determining the responsible party for discrepancies, whether it is USDA or grain merchandisers, would be a step in the right direction. I would also encourage greater transparency into the process of setting PCPs with better utilization and reflection of local markets.

Thank you, Chairman Moran and Ranking Member Etheridge, for this opportunity. I am happy to answer any questions you may have.



Testimony presented to the

Subcommittee on General Farm

Commodities and Risk Management

Review of Technical Procedures of USDA's
Establishment of Posted County Prices

By

Greg Shelor

Vice President for Legislation

National Sorghum Producers

December 14, 2005

Introduction

Mr. Chairman, members of the Committee, on behalf of sorghum producers nationwide, I would like to thank you for your interest in sorghum and, in particular, for today's hearing reviewing the technical procedures of USDA's establishment of Posted County Prices.

This issue is of utmost importance to members of the National Sorghum Producers (NSP) and has generated more inquiries to our office than any other issue this year. Sorghum producers are in need of immediate action to correct a flawed system that threatens the foundation of the farm safety net provided for in the 2002 farm bill.

As we have contacted USDA with our concerns regarding the program, they have been receptive to working with producers in correcting problems. We applaud USDA for these efforts as well as their implementation of the eLDP program which has sped up the process of farmers' receiving their loan deficiency payments (LDPs) in a timely manner.

My name is Greg Shelor, and I produce grain sorghum, wheat and corn near Minneola, Kansas, in the southwest part of the state. I currently serve as vice president for legislation for the National Sorghum Producers (NSP). NSP represents U.S. sorghum producers nationwide. Headquartered in the heart of the U.S. sorghum belt at Lubbock, Texas, our organization works to ensure the profitability of sorghum production through market development, research, education, and legislative representation.

Last year, my home state of Kansas yielded the nation's most bushels of grain sorghum. Other top producers include Texas, Nebraska, Missouri, Oklahoma, and South Dakota. In 1996, U.S. sorghum producers harvested 11.8 million acres and produced 795 million bushels of grain. In 2004, however, production fell to 455 million bushels on 6.5 million harvested acres – a 43% decrease in production. At the same time, high-water use crops displaced sorghum acres in the semi-arid sorghum belt.

Grain sorghum is a water-sipping crop that demands less water than other crops and has the ability to withstand dry conditions by becoming temporarily dormant during moisture stress. Thus, in areas where water supplies are limited and rainfall is minimal, grain sorghum and forage sorghum conserve an important resource while offering more

yield stability with less risk. Water concerns in most of the sorghum-producing states are focused on water quantity, not water quality.

University studies have compared water savings through alternative cropping patterns and the use of crops that require less water, such as grain sorghum. As the following table illustrates, Dr. Terry Howell from the USDA-ARS facility in Bushland, Texas found that seasonal water use for sorghum is 25% less than other feed grains.

Table 1: Seasonal Water Use

Seasonal Water Use	
Other feed grains	30.3 inches
Sorghum	22.7 inches

A water savings of 7.6" per year is substantial and its true magnitude is apparent when looking at aggregate acres. A Panhandle Water Planning Group regional water plan, prepared as a requirement for 1999 Texas water legislation (Senate Bill 1), found that the total 50-year water savings for six counties in the Texas Panhandle would amount to 6.5 million acre-feet of water if producers converted acres from irrigated corn to irrigated grain sorghum.

Taking this to a regional scope, water savings from irrigated corn acreage converted to grain sorghum acreage could be astounding when looking at total irrigated corn plantings in Nebraska, Kansas, Texas, Colorado, and Oklahoma.

Table 2: Irrigated Corn Acres (2004)

Irrigated Corn Acres Planted: 2004	
Nebraska	5,020,000
Kansas	1,490,000
Texas	870,000
Colorado	825,000
Oklahoma	130,000
Total	8,335,000

From a conservation standpoint, the question is simple: How can a limited resource be most efficiently used? We believe that wise use of future water supplies should be a priority, and a farm program that takes that into consideration would help producers be able to afford to conserve water.

Sorghum is a unique, drought tolerant crop that plays a vital role in water conservation for many U.S. farmers. NSP will continue to work with Members of this committee and USDA to strengthen the support for this crop. As farmers see natural gas and fertilizer prices climb, they are looking now at optimum production levels and crop mixes – not maximum production. Sorghum utilizes 25% less energy for irrigation and 27% less fertilizer than corn. These cost of production numbers are favorable for sorghum, but when LDPs are inconsistent between crops, farmers find it difficult to accurately predict their future returns or make planting decisions based on these cost of production numbers.

Current Policy

The equalization of the program loan rates for corn and sorghum was the key priority of sorghum producers in the 2002 Farm Bill. Members of this subcommittee played a vital role in shepherding that equalization through Congress. Both grains substantially yield the same amount of ethanol, the fastest growing value-added market for sorghum.

During the past couple of cropping years, USDA implemented a regional LDP system. It has only recently come to our attention as prices for sorghum have declined to significantly below loan rates for the first time since the new system was implemented. The switch to a regional LDP has rendered the PCP process ineffective. Farmers view the process to determine LDPs as arbitrary. PCPs are adjusted for each county to assure that all counties have the same LDP in a region. This switch led to even more significant differences between feed grain LDPs. Most farmers look at the LDP as the difference between the county loan rate and the posted county price (PCP). The Farm Service Agency (FSA) of USDA publishes the PCP for every county to represent the county cash price. The LDP is only paid when the PCP is below the loan rate and is only paid on bushels produced by the farmer.

In contrast to the county-level LDP, the geographic area covered by the regional LDP can be quite large. On Oct. 20, the LDP was the same (with the exception of an area in South Texas) for the top eight sorghum-producing states—Kansas, Texas, Nebraska, Colorado, Oklahoma, Missouri, Illinois, and South Dakota. **These states produced 95% of U.S. grain sorghum in 2004, and NSP feels the area is too large for one single LDP level set by USDA.**

On Oct. 20, the cash price for sorghum in Dodge City, Kan. and Russell, Kan., was the same at \$1.52 per bushel. The LDP was also the same at 30 cents per bushel. However, the loan rate in Russell is 15 cents per bushel less than the loan rate in Dodge City. This means there was a 15 cent per bushel discrepancy in the LDP. In this instance, Dodge City's LDP was 11 cents per bushel less than the pre-regional system, and Russell was 4 cents per bushel more than the pre-regional system. The Russell market is influenced by a local ethanol plant and this is reflected in its cash price. A regional LDP system cannot accommodate such variations in local markets and weakens farmers' confidence in the system. For further discrepancies in cash prices and LDP rates, please see Table 3.

Table 3: Sorghum Price Data as of 10/20/05 (\$/bu)

Location	Cash Price (\$/bu)	LDP (\$/bu)	Loan Rate (\$/bu)	Discrepancy from Pre-Regional System (\$/bu)
Dimmitt, TX	1.82	0.30	2.12	0.00
Keyes, OK	1.64	0.30	1.99	-0.05
Dodge City, KS	1.52	0.30	1.93	-0.11
Garden City, KS	1.53	0.30	1.92	-0.09
Colby, KS	1.55	0.30	1.79	0.06
Smith Center, KS	1.36	0.30	1.78	-0.12
Greeley, KS	1.49	0.30	1.84	-0.05
Russell, KS	1.52	0.30	1.78	0.04
Claude, TX	1.65	0.30	2.11	-0.16
Syracuse, KS	1.52	0.30	1.92	-0.10
Perryton, TX	1.74	0.30	2.03	0.01

When comparing feed grains, the discrepancy introduced by the regional LDP is even more noticeable. On Oct. 20, the LDP was 41 cents per bushel for corn and 30 cents per bushel for sorghum for counties in Kansas, Texas and Oklahoma. A producer in Claude, Tex., sold his corn on Oct. 20 for \$2.17 per bushel, the price that most buyers

were willing to pay in his county. Given that the 2005 corn loan rate was set in his county at \$2.25, he assumed that the LDP would have been about the difference between the loan rate and his cash price – 8 cents. He actually received an LDP of 41 cents.

Table 4: 10/20/05 Price Data (\$/bu)

Claude, Tex., Corn Price Data	
Corn Loan Rate	\$2.25
Corn Cash Price	\$2.17
LDP payment under pre-regional system	\$0.08
<i>Actual</i> Corn LDP	\$0.41

As you can see, there is a significant difference in the level of support that producers received under the regional LDP system versus the pre-regional system. Another way to look at this is the USDA *implied* loan rate. The implied loan rate is simply what the loan rate would have to be given the current LDP. In the case above, the implied loan rate for corn would be \$2.58 per bushel. This is the cash price of \$2.17 plus the LDP of 41 cents.

The same farmer sells his sorghum on the same day at a price of \$1.65. With the loan rate set at \$2.11, he could have expected about a 46 cent per bushel LDP. Instead, his actual sorghum LDP was 30 cents per bushel.

Table 5: 10/20/05 Price Data (\$/bu)

Claude, Tex., Sorghum Price Data	
Sorghum Loan Rate	\$2.11
Sorghum Cash Price	\$1.65
LDP payment under pre-regional system	\$0.46
<i>Actual</i> Sorghum LDP	\$0.30

In this case, the regional LDP is less than the LDP that would have been paid under the old system. In the case of sorghum, the implied loan rate is \$1.95 per bushel. This is the cash price of \$1.65 plus the 30 cent LDP.

Table 6: 10/20/05 Price Data (\$/bu)

Claude, Tex., Implied Loan Rates	
Corn Implied Loan Rate	\$2.58
Sorghum Implied Loan Rate	\$1.95
Implied Difference	\$0.63

Sorghum farmers are puzzled over this difference of 63 cents. The 2002 Farm Bill equalized the sorghum and corn loan rates on a national level, but now sorghum farmers are seeing a difference in the USDA implied loan rates of as much as 66 cents per bushel. Sorghum farmers seek to reduce the difference in the calculation of the regional LDP.

If the regional LDP is not corrected, sorghum farmers will be given an incentive to place their sorghum under loan where they will be capturing, in the example above, an additional 16 cents per bushel with the possibility of forfeiting grain to USDA. NSP encouraged farmers in these circumstances to place their grain under loan, but many farmers could not. Rising energy costs and falling commodity prices have squeezed farmers' cash flows. From a cash flow perspective, a farmer who takes the cash price for his sorghum and takes the LDP is better off than placing grain under loan and prepaying an average of 27 cents a bushel for storage. This decision is driven strictly by cash flow.

The sorghum belt has very little on-farm storage compared to the Midwest Corn Belt, so the loan program does not work as a cash flow tool. In the sorghum belt, the LDP is used as a cash flow tool. Given the inaccuracies in the PCPs, many producers also play a dangerous game with the LDP. Seeing that their cash price and the PCP do not move in parallel as they should, producers will take the LDP on a "high" day and not market their sorghum. This removes the floor placed under the grain by the Farm Bill and exposes the producer to unlimited downside risk. This "redeem and dream" marketing plan offers cash flow to the producer - but is not the use of the LDP program intended by the authors of the Farm Bill.

The intent of the 2002 Farm Bill was to continue the LDP program in an effort to keep the Commodity Credit Corporation from owning grain which results in increased

government outlays. NSP supports an effective and accurate LDP system that lets the market clear, and in doing so, does not place grain under loan. Grain under loan will affect local cash prices at a later date and further distort cash data used to set PCPs.

Again, the switch to a regional LDP has rendered the PCP process ineffective as the LDP is calculated and PCPs are adjusted for each county to assure that all counties have the same LDP in a region.

Another important reason for correcting the PCP procedure is the affect that PCPs have on succeeding years' loan rates. According to a FAPRI report, under current USDA procedures, USDA multiplies the average sorghum PCP by the average sorghum production to estimate the county's average value of sorghum production. These values are summed for all counties in the nation and then divided by the national sorghum production. This results in a national average PCP. USDA then divides the national sorghum loan rate by the national average PCP to compute a county loan rate factor. The county loan rate factor is then multiplied by the county average PCP to arrive at the county loan rate. Using this system, USDA is using PCPs to act as a proxy for the cash price of sorghum. This lends to problems when USDA has gone to a regional loan deficiency payment (LDP) system as seen in the previous examples.

Correction Option for PCPs

A better solution for correcting the errors in PCP calculations is to have smaller regions. In the past, county-specific LDPs have proved problematic for elevators due to producers transporting grain across county lines to receive a greater LDP. A region of any size would have transportation problems, but USDA seems to have found that the number of problems is reduced with larger regions. Sorghum producers believe that the regional LDP concept has created many problems. As evidenced in the examples above, the discrepancy in the LDP can be as much as half of the LDP itself. As previously mentioned, NSP would encourage USDA to reduce the size of the regions for determining LDP's. If the goal was to eliminate county-by-county problems, USDA has gone too far.

It would be better to move to smaller regions that have representative production practices and markets. NSP recommends a switch to the same regions used by the

National Agricultural Statistics Service. The reporting districts are well established and represent similar production practices and markets. Again, at the edge of a region, there will always be transportation issues, but the appropriate size of the reporting districts should help in reducing the number of these problems.

Conclusion

It is imperative that USDA implement the 2002 Farm Bill in a manner that does not seem arbitrary to our members and that accurately carries out the purpose of the LDP program. NSP urges USDA to re-visit their regional approach to calculating LDPs and to use smaller regions to better reflect actual prices in the cash market.

NSP is committed to working with the Committee, its staff, and USDA to ensure proper implementation of the Farm Security and Rural Investment Act of 2002. Sorghum is playing a much larger role in non-traditional markets since the passage of the 2002 Farm Bill. These changes must be accounted for in USDA's implementation of policy that affects all U.S. producers. Sorghum is a vital part of many producers' operations and must receive equal treatment by USDA. USDA's implementation of the LDP program, which is determined by the PCPs, must not interfere with farmers' cropping decisions.

General Farm Commodities and Risk Management Subcommittee Hearing
Review of Technical Procedures of USDA's Establishment of Posted County Prices
December 14, 2005

Question by Mr. Scott (Georgia) for Secretary Floyd Gaibler

Mr. Gaibler, your testimony helped to clarify for me the differences between how the Marketing Assistance Loan Program operates for wheat, feed grains and oilseeds and another crop grown in Georgia, peanuts. As you know, the 2002 Farm Bill changed the U.S. peanut program dramatically. Congress sought to change the supply/management program to a more market oriented program similar to other commodities.

Despite these changes, the posted price for peanuts has remained much higher than what peanuts are being traded internationally. U.S. export markets have not increased because of the high posted price. This seems counter to what Congress intended with the new peanut program.

How strongly does the USDA weigh increasing peanut exports in determining the posted price? Are prices offered by U.S. competitors given equal weight with other variables used in determining the posted price such as minimizing government costs?

Response to Mr. Scott:

The changes Congress made to the peanut program with the 2002 Farm Bill have achieved a more competitive U.S. peanut industry overall, evidenced by acreage shifts that have boosted yields and production, and accelerated demand growth. Exports have declined only slightly from their pre-2002 levels, but a more revealing barometer of success would include the strides made in the domestic food market, which comprises over 60 percent of total U.S. peanut use. Since 2001, domestic food use has grown 20 percent, domestic origin food use has grown 31 percent, and imports have fallen 90 percent.

Imports now make up less than 1 percent of U.S. peanut supply; as of December 12, 2005, imports from Argentina, our major competitor, totaled 3.7 percent of the available quota that opened April 1, 2005. The US market has ceased to be an outlet for Argentine peanuts, although Argentine exporters now market peanuts to Europe, the primary export destination of U.S. peanuts. In effect, the U.S. has recaptured Argentina's share of the domestic peanut market, but at the expense of competing with displaced Argentine peanuts in Europe.

Despite the additional competition from Argentina, U.S. peanut exports remain impressive. Exports have totaled around 500 million pounds annually in the years since the 2002 Farm Bill and are forecast at 530 million pounds in 2005, a performance on par with many of the years preceding the 2002 Farm Bill.

The 2002 Farm Bill replaced the two-tiered price support program, one which distinguished between the domestic food market at one price and the crush and export markets at a lower price, to a single support price marketing loan program with direct and counter-cyclical payments and a quota buyout program. The 2002 Farm Bill directs the Secretary to set the loan repayment rate for peanuts at a rate that will: (1) minimize potential loan forfeitures; (2) minimize the accumulation of stocks by the federal government; (3) minimize the cost incurred by the federal government in storing peanuts; and, (4) allow peanuts produced in the United States to be marketed freely and competitively, both domestically and internationally. As intended, this change to the loan repayment rate reflects the value of peanuts in all end uses and does not seek to direct peanuts to one market over another.

Peanut exports only represent around 12 percent of total U.S. peanut use. USDA does not include export prices as variables in calculating the marketing assistance loan repayment rate because there is no reliable source for peanut export prices of any origin. USDA also does not use non-price indicators like export levels or government costs as variables in this calculation. Instead, the rate is based on spot market transactions for domestically produced peanuts and other relevant market information. Since some spot market transactions include the purchase of peanuts for export, the value of peanuts for the export market are included in the determination.

Thank you for the opportunity to respond to your question.

STATEMENT OF EVAN HAYES

Mr. Chairman and Members of the Subcommittee, barley producers greatly appreciate this hearing to shed light on USDA's procedures for establishing posted county prices, which are used to calculate our daily loan deficiency payments (LDPs).

As you are aware, LDPs have become an important part of the three-legged domestic farm support program provided to producers of program crops under the 2002 farm bill. In times of low commodity prices, like in 2005, producers actively use the marketing loan and LDPs in their crop marketing strategies, as the statute intended. However without transparent procedures, many of our producers believe USDA manipulates posted county prices through arbitrary differentials in order to minimize their outlays under loan deficiency payments and marketing loan gains. This concern was evident in numerous counties across the county this year where posted county prices for barley failed to reflect prevailing marketing conditions.

Two examples will illustrate the contradictions in USDA's current implementation of posted county prices and LDP calculations. In some markets, the PCP was considerably lower than prevailing market prices and in others the PCP was higher than local market prices, causing distortions in the daily LDPs.

Example One: Idaho barley has two terminal markets for barley: PNW (Portland export market) and West Coast Domestic (WCD). At peak August 2005 harvest, barley terminal prices were \$2.52 per bushel for PNW and \$2.76 per bushel for WCD. The differentials for Caribou County, Idaho were -\$0.48 per bushel for PNW (+ adjustment factor of -\$0.19) and -\$0.73 per bushel for WCD (+ adjustment factor of -\$0.18).

This resulted in a posted county price for barley in Caribou County, Idaho on August 24 (after new differentials were announced) of \$1.85 per bushel (higher of the two terminal markets minus their respective differentials).

PNW - \$2.52 - \$0.67 (0.48 + 0.19) = \$1.85 per bushel
 WCD - \$2.76 - \$0.91 (0.73 + 0.18) = \$1.85 per bushel
 LDP calculation: \$2.03/bu loan rate - \$1.85/bu PCP = \$0.18 per bushel

The actual local market price on August 24 was \$1.80 per bushel. Example two. North Dakota barley has two terminal markets for barley: Minneapolis and PNW. For the 2005 crop, barley terminal prices were \$1.83 per bushel for Minneapolis and \$2.46 per bushel for PNW. The differentials for Cass County, North Dakota were -\$0.46 per bushel for Minneapolis (+ adjustment factor of -\$0.02) and -\$1.00 per bushel for PNW (+ adjustment factor of -\$0.19).

This resulted in a posted county price for barley in Cass County, North Dakota of \$1.35 per bushel (higher of the two terminal markets minus their respective differentials).

Minneapolis - \$1.83 - \$0.48 (0.46 + 0.02) = \$1.35 per bushel
 PNW - \$2.46 - \$1.19 (1.00 + 0.19) = \$1.27 per bushel
 LDP calculation: \$1.63/bu loan rate - \$1.53/bu PCP = \$0.28 per bushel.

The local market price for feed barley in Cass County ranged from \$1.50 to \$1.80 per bushel (depending on DON levels).

We request the following concerns be addressed:

1. Nontransparent process to establish differentials that are used to derive Posted County Prices. There should be a transparent process used by USDA to establish differentials. These differentials should accurately reflect transportation distances and costs between the terminal markets and specific counties. We believe differentials should be updated more frequently than once a year to reflect changing market conditions. Certainly, the rising fuel transportation costs in 2005 should have warranted more timely adjustments in the differential.

USDA made two adjustments in barley differentials this year: in August and again in early December. These adjustments caused LDPs to increase in some areas of the country and to fall sharply in others. Again, because of a lack of transparency in the procedures for calculating differentials, producers were left wondering what would happen next and uncertain when to market their crops and claim their LDPs. For a large majority of barley producers this year, the adjustments came too late for any financial benefit as they had lost beneficial interest in their crops.

2. Manipulating PCPs to achieve equal LDPs across counties. We understand the logic for equalizing LDPs across neighboring counties to prevent producers from shopping their commodity around to achieve the highest LDP. However, this manipulation in both county loan rates and differentials has produced anomalous conditions in several counties where the PCP has diverged widely from actual market prices. Given the high cost of transportation fuel, it is highly unlikely that producers will transport their bulk commodities any appreciable distance to take advantage of different LDPs.

Again, we appreciate the subcommittee conducting a serious inquiry into how posted county prices are established for program crops.

