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Federal Crop Insurance: Issues in the 106th Congress

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Federal Crop Insurance: Issues in the 106th Congress

Summary

Policymakers have been examining the efficacy of current farm risk management programs, most notably the federal crop insurance program, and are in the midst of considering major legislative changes. The current economic condition of the farm sector (low commodity prices) and farmer discontent with some of the modifications made by the 1996 farm bill to the farm commodity price support programs are prompting congressional action.

The federal government has spent an average of $1.5 billion per year on crop insurance since 1994. The government pays the full cost of the premium for catastrophic (CAT) coverage and pays a portion of the premium for higher levels of coverage. Private insurance companies sell and service the policies, but are reinsured by the government for most of their losses and expenses.

Major reforms were made to the crop insurance program in 1994 in hopes of permanently replacing expensive ad hoc disaster payment programs with a more heavily subsidized crop insurance program. However, the enactment of multi-billion dollar farm financial assistance packages in both FY1999 and in FY2000 has encouraged consideration of additional modifications. Some are opposed to providing any additional federal funds to crop insurance because of concerns that such subsidies encourage farmers to bring environmentally fragile land into production.

Overall farmer participation in the program has increased in recent years, but participation rates for levels of coverage beyond the CAT level, have not changed significantly. Several farm and insurance industry groups have identified a number of factors that they perceive inhibit participation. Among these are 1) a declining rate of premium subsidy by the federal government as levels of coverage increase; 2) insufficient coverage for those who experience multiple years of disasters; 3) the lack of any insurance products for livestock producers; and 4) the need to compensate private companies for developing new risk management programs.

On September 29, 1999, the full House approved a comprehensive crop insurance bill (H.R. 2559), which would increase the portion of the premium paid by the government, provide improved coverage for farmers affected by multiple years of natural disasters, authorize pilot insurance programs for livestock farmers, and give the private sector greater representation in policymaking.

The cumulative cost of H.R. 2559 is estimated at about $6 billion through FY2004. Authority for any new spending comes from the FY2000 budget resolution, which allows for a reserve fund of $6 billion that can be used for farm risk management modifications or income assistance, beginning FY2001.

A bill in the Senate comparable to H.R. 2559 is the Roberts-Kerrey bill (S. 1580). Senate Agriculture Committee Chairman Lugar has introduced legislation (S. 1666) that would take a different approach to farm risk management enhancement by providing a direct payment to any farmer who adopts at least two risk management practices. Because of the lack of consensus, committee markup was postponed until no later than March 8, 2000. Separately, the FY2000 agriculture appropriations act (P.L. 106-78) contains emergency spending of $400 million to further subsidize crop insurance premiums in the 2000 crop year.

MOST RECENT DEVELOPMENTS

On September 29, 1999, the full House passed by voice vote a comprehensive crop insurance enhancement bill (H.R. 2559), which, among its many provisions, offers higher levels of premium subsidy and improves yield coverage when a farmer is affected by multiple years of disasters. Also on September 29, Senate Agriculture Committee Chairman Richard Lugar introduced legislation (S. 1666) that takes a different approach than H.R. 2559 to encourage farmers to manage their risk. S. 1666 would provide $5 billion in additional direct payments over 4 years to farmers who adopt at least two risk management practices, including crop insurance and participation in the futures market. Supporters of a Kerrey-Roberts bill (S. 1580), which is comparable in scope to H.R. 2559, had pressed for a committee markup of their crop insurance bill. Sponsors of the two pending Senate measures (S. 1666 and S. 1580) were unable to reach a compromise before the end of the 1999 session. Supporters of S. 1580 had planned to offer their bill as an amendment to separate legislation before Congress adjourned for the year. However, an announcement by Chairman Lugar that the committee will mark up a risk management/crop insurance bill by March 8, 2000 led to the withdrawal of the amendment.

Meanwhile, the FY2000 agriculture appropriations bill (P.L. 106-78, H.R. 1906) , was signed into law on October 22, 1999. P.L. 106-78 contains emergency spending of $400 million for USDA to offer a discount on the farmer-paid premium for crop insurance in the 2000 crop year.

BACKGROUND AND ANALYSIS

Background

Farming is commonly viewed as an inherently risky enterprise. In their operations, farmers are exposed to both *production* risks and *price* risks. Farm production levels can vary significantly from year to year, primarily because farmers operate at the mercy of nature and frequently are subjected to weather-related and other natural disasters. Farm operators can also experience wide swings in the prices they receive for the commodities they grow, depending on total production levels and demand conditions both domestically and internationally. Since farm income is primarily determined by the combination of production and prices, annual farm income therefore can be volatile.

Over the years, the federal government has played an active role in helping to temper the effects of risk on farm income. On the production side, the government has widely expanded coverage and increased the subsidy of the federal crop insurance program. To help mitigate price risk, the government for many years administered price and income support programs for producers of major field crops. Beginning in the 1970s and up until 1996, these commodity support programs provided direct payments to participating producers, when market prices fell below a government-set target price. However, the omnibus 1996 farm bill (P.L. 104-127) terminated target price deficiency payments for wheat, feed grains, cotton and rice growers and replaced them with fixed but declining 7-year annual contract payments that are no longer tied to market prices. Consequently, farmers have been required to assume greater responsibility for managing their price risk. Pilot projects were authorized by the

1996 farm bill to develop revenue insurance (income protection) products as part of the federal crop insurance program.

A confluence of several events has caused many farm groups and policymakers to call for a reexamination of federal farm risk management programs, especially the crop insurance program. In late 1997, prices for many of the major farm commodities declined significantly, causing a drop in farm income for many producers. Also, over the last several years, some regions have experienced multiple years of natural disasters, which have limited production and reduced farm income. Many farm groups have complained that the current crop insurance program has provided inadequate coverage for producers when natural disasters strike. They also contend that the 7-year contract payments do not provide adequate protection for farmers when prices drop as they have since 1997.

In response to farm group pleas for assistance, a nearly $6 billion emergency farm financial assistance package (P.L. 105-277, the FY1999 Omnibus Appropriations Act) was enacted in 1998 to address losses caused by low prices and natural disasters. Half of this amount went to contract payment recipients in the form of direct income-support. Most of the balance was paid to any producer (including contract holders) who experienced either a 1998 crop loss or multiple-years of losses caused by a natural disaster. (For more on this assistance, see CRS Report 98-952, *Emergency Agricultural Provisions in the FY1999 Omnibus Appropriations Act*.) An $8.7 billion financial assistance package was enacted within the FY2000 agriculture appropriations act (P.L. 106-78) as many commodity prices remained low in 1999. Because of the large price tag associated with these assistance packages, the 106th Congress is considering major modifications to the current federal crop insurance program and is seeking ways to enhance available risk management tools so that future ad hoc financial and disaster assistance programs might be avoided.

Crop Insurance Basics

The federal crop insurance program is administered by the U.S. Department of Agriculture's Risk Management Agency (RMA). The program is designed to protect crop producers from unavoidable risks associated with adverse weather, plant diseases, and insect infestations. Insurance policies are sold and completely serviced through approved private insurance companies that have their losses reinsured by USDA. Whether or not a crop is covered under the program is an administrative decision made by USDA. The decision is made on a crop-by-crop and county-by-county basis, based on farmer demand for coverage and the level of risk associated with the crop in the region, among other factors. Most of the major crops (wheat, corn, other feed grains, cotton and rice) are covered in nearly every county in which they are grown. Fruits, vegetables and other specialty crops are also covered, but availability of coverage varies by region. In total, approximately 70 crops are covered.

There are four sources of federal costs for the crop insurance program. USDA absorbs a large percentage of the program losses (the difference between premiums collected and indemnities paid out), subsidizes a portion of the premium paid by participating producers, compensates the reinsured companies for a portion of their operating and administrative expenses, and pays the salaries and expenses of the RMA. (See Table 1.)

Table 1. Government Cost of Federal Crop Insurance
— in Thousand $ —

Fiscal Year	Net Program Losses or (Gains)[a]	Premium Subsidy[b]	Adminis. Expense Reimbursem.[c]	Other Administrative Costs[d]	Total
1981	97,056	46,966	0	104,714	248,736
1982	(60,361)	91,418	18,506	110,341	159,904
1983	146,645	64,559	26,184	96,715	334,103
1984	211,411	98,352	75,709	101,905	487,377
1985	215,896	100,088	107,275	98,110	521,369
1986	215,824	89,633	101,308	97,465	504,230
1987	55,563	73,391	106,990	73,318	309,262
1988	609,404	103,379	154,663	77,981	945,427
1989	400,023	190,546	265,890	88,080	944,539
1990	233,872	213,297	271,616	87,146	805,931
1991	246,986	196,146	245,157	83,928	772,217
1992	232,261	197,405	245,995	88,352	764,013
1993	750,654	197,543	249,817	104,745	1,302,759
1994	(126,934)	246,589	291,738	78,053	489,446
1995	187,719	774,114	373,094	104,591	1,439,518
1996	87,961	978,499	490,385	64,165	1,621,010
1997	(373,015)	945,024	450,253	73,669	1,095,931
1998	(75,039)	940,157	426,895	81,682	1,373,695
1981-1998 FY Total (e)	3,055,926	5,547,106	3,901,475	1,614,960	14,119,467

[a] Net Program Losses = Total Premiums less Loss Claims adjusted for net gains or losses shared with private insurance companies
[b] Premium Subsidy = Portion of Total Premium Paid by the Government
[c] Administrative Expense Reimbursements = Paid to Private Insurance Companies for their Delivery Expenses
[d] Other = Primarily the Salaries and Expenses of USDA's Risk Management Agency
[e] FY1999 data are not yet available, and are expected to be released by USDA in its FY2001 budget request in Feb. 2000.

Source: USDA Risk Management Agency

Under the current program, a participating producer is assigned: 1) a "normal" crop yield based on the producer's actual production history, and, 2) a price for his commodity based on estimated market conditions. The producer can then select a percentage of his normal yield to be insured and a percentage of the price he wishes to receive when crop losses exceed the selected loss threshold. The producer pays a premium that increases as the levels of insurable yield and price coverage rise. However, all eligible producers can receive catastrophic (CAT) coverage without paying any premium. The premium for this level of coverage is completely subsidized by the federal government. The farmer pays an administrative fee of $60 per crop per county for CAT coverage, and in return can receive a payment equal to 55% of the estimated market price of the crop, on losses in excess of 50% of normal yield.

Any producer who opts for CAT coverage has the opportunity to purchase additional insurance coverage from a private crop insurance company. For an additional premium paid by the producer, and partially subsidized by the government, a producer can "buy up" the 50/55 catastrophic coverage to any equivalent level of coverage between 50/100 and 75/100, (i.e, up to 75% of "normal" crop yield and 100% of the estimated market price.) In limited areas (mainly the Northern Plains), production can be insured up to the 85/100 level of coverage.

A buy-up option that has been available since 1997 on a pilot basis on major crops and has been quite popular is revenue insurance. Revenue insurance combines the production guarantee component of crop insurance with a price guarantee to create a target farm revenue guarantee for a crop farmer. Under revenue insurance programs, participating producers are assigned a target level of revenue based on market prices for the commodity and the producer's production history. An insured farmer who opts for revenue insurance can receive an indemnity payment when his actual farm revenue falls below a certain percentage of the target level of revenue, regardless of whether the shortfall is caused by low prices or low production levels.

For farmers who grow a crop that is not insurable under the federal crop insurance program, USDA has permanent authority to make direct payments to farmers under the Noninsured Assistance Program (NAP). NAP provides payments equal to the catastrophic level of insurance coverage (55% of the market price paid on losses in excess of 50% of normal yields) to any producer in a region that has experienced a 35% crop loss. For more information on the mechanics of crop insurance, see *Managing Risk in a New Policy Era* (CRS Report 97-572) and *Farm Disaster Assistance: USDA Programs and Recent Legislative Action* (CRS Report 98-682).

Crop Insurance Issues and Congressional Action

Recent surveys have shown that nearly two-thirds of eligible acreage is enrolled in the crop insurance program. However, a quarter of all eligible acreage is enrolled only in catastrophic (CAT) coverage, which is the most basic level of coverage designed to minimally protect producers against a major disaster. Although farmers are encouraged to purchase buy-up coverage to further protect against production risks, only about 40% of eligible acreage has been enrolled in buy-up coverage in recent years, a level that has not changed

much through the 1990s. Many farm groups argue that bolstering participation in crop insurance should be a high priority. If crop insurance is affordable and provides adequate coverage, supporters say, it would forestall political pressure for expensive ad hoc disaster payment bills each year. Many farm groups also would like to see the current revenue insurance programs be made more widely available, especially in light of current low commodity prices and the elimination of target price deficiency payments for major commodities.

Others argue for a more deliberate approach to any changes to the program. Some are concerned that applying any more federal money to crop insurance might not be fiscally prudent, especially since program reforms in 1994 did not preclude the need for over $15 billion in *ad hoc* farm financial assistance provided by Congress in FY1999 and FY2000. (The 1994 reforms infused $1 billion per year of new spending and required that producers who opt out of crop insurance sign a waiver disqualifying them from receiving any disaster payments. Disaster assistance provisions in subsequent appropriations acts allow producers to receive disaster payments irrespective of the waivers. The 1994 act also reserved $400 million in disaster funds to further subsidize crop insurance premiums for the 1999 crop year.) Critics wonder if any new federal money should be channeled into crop insurance before a more thorough investigation of whether crop insurance is the proper federal risk management tool. Critics also point out that reform of the federal program might be caught in a catch-22: the federal program will not be improved until participation improves, say critics, but participation will not increase as long as ad hoc disaster payments are regularly made available. Others are concerned that increased crop insurance subsidies will promote overproduction, which could potentially depress farm commodity prices, and cause environmentally sensitive land to be entered into production.

The federal crop insurance program has been scrutinized by the Administration, the House and Senate Agriculture Committees, and various farmer and insurance industry groups, to identify any shortcomings that might be discouraging farmer participation. A series of hearings was conducted on crop insurance/risk management issues in both the House and Senate Agriculture Committees earlier this year. The Risk Management Subcommittee of the House Agriculture Committee completed markup of comprehensive legislation (H.R. 2559) on July 21, 1999. Full House committee action was completed on August 3. H.R. 2559 was passed by voice vote on September 29, 1999. The budget parameters for legislative changes were established by the FY2000 budget resolution (H.Con.Res. 68), which provides a $6 billion reserve fund for any reported legislation that provides "risk management or income assistance for agricultural producers in FY2001 through FY2004." (See "Budgetary Impact of Crop Insurance Legislation" below.)

In the Senate, several crop insurance bills have been introduced to address many of the perceived problems with the program. S. 1580 (Roberts/Kerrey) and S. 1109 (Cochran/Lincoln) would make modifications to the crop insurance program similar to H.R. 2559. Senator Richard Lugar, the chairman of the Agriculture Committee, has stated that increased subsidies for crop insurance might not be the most efficient way to encourage farmers to manage their risk. He has introduced legislation (S. 1666) that would take a different approach than H.R. 2559 or any of the Senate crop insurance bills. S. 1666 would allow any farmer to receive a direct payment, if the farmer adopts at least two risk management practices, such as purchasing a crop insurance policy or entering into a futures or option contract, among other specified possibilities. Total farmer payments would be $5

billion over 4 years (2001-2004) and would be based on the farmer's historical crop yields. Producers could receive a payment regardless of whether the producer grows an insurable crop.

Supporters of S. 1580 had planned to offer their bill as a floor amendment to separate legislation before Congress adjourned for the year in November 1999. An announcement by Chairman Lugar that the committee will mark up a risk management/crop insurance bill by March 8, 2000 led to the withdrawal of the amendment.

Meanwhile, the FY2000 agriculture appropriations act (P.L. 106-78) was signed into law on October 22, 1999. The measure contains emergency spending of $400 million for USDA to offer a premium discount to all farmers who purchase crop insurance in the 2000 crop year. A similar provision was contained in the FY1999 omnibus appropriations act (P.L. 105-277), which enabled USDA to reduce the farmer-paid premium by approximately 30% in the 1999 crop year. In addition to the $400 million in additional premium subsidy, CBO estimates that the provision will cost the government $250 million in FY2000 program-related costs (including reimbursements to the private insurance companies for their administrative costs and potentially higher indemnity payments to participating farmers.)

The Administration has not offered specific legislation to modify crop insurance. However, the Administration's views on crop insurance issues are contained in two documents — a Feb. 1, 1999 white paper entitled *Strengthening the Farm Safety Net: The Administration's Principles and Preliminary Proposals for Reforming Crop Insurance* (available at [http://www.usda.gov/news/releases/1999/02/crop]) and recent USDA testimony before Congress [http://www.act.fcic.usda.gov/pubafrs/ar/house_031099.html]. Additional crop insurance proposals might also be offered by the Administration when it releases its FY2001 budget request on February 7, 2000.

The following sections highlight some of the major perceived problems with the program and review the Administration position and selected legislative options offered to date. (See the "Legislation" section at the end of this report for a synopsis of introduced bills.)

Premium Subsidy

Under the current program, USDA determines for each insurable crop what the total premium needs to be to cover the expected indemnity (loss) payments, so that the program can operate on an actuarially sound basis. The federal government spends just under $1 billion each year subsidizing the total premium to make insurance more affordable for farmers. The premium for catastrophic (CAT) coverage (50/55 coverage, i.e., losses in excess of 50% of normal yields are covered at 55% of the estimated market price) is subsidized 100% by the federal government. However, the percentage of the premium subsidized by the government declines as the level of coverage rises. For example, in 1998 the government on average paid: 55% of the premium for 50/100 coverage; 42% of the premium for 65/100 coverage; and 23.5% of the premium for 75/100 coverage. Under current law, the government is prohibited from subsidizing the additional premium cost of increasing the level of coverage from 65/100 to 75/100 coverage. Also, producers have to pay the full cost of the premium for adding the price-protection component of revenue insurance to the standard crop insurance policy. Consequently, many policymakers believe that the current subsidy structure does not provide enough incentive for farmers to purchase

an adequate level of insurance. Many argue that the subsidy structure should be inverted so that the government pays a higher percentage of the subsidy as the level of coverage increases, and that the premium for revenue insurance products be subsidized at the same rate as standard crop insurance. Others, however, are concerned that overly generous subsidies might encourage planting in high risk areas and increase the risk exposure of the government. (See Table 2 below for a comparison of current subsidy levels with proposed changes.)

Table 2. Comparison of Premium Subsidies: Current Law and Selected Proposals

Government-Paid Portion of Premium as a Percent of Total Premium

Coverage Level	Current Law (1)	Administration Proposal	H.R. 2559 (House-Passed)	Roberts-Kerrey (3) (S. 1580)	Cochran-Lincoln (S. 1108)
50/55	100%	(2)	100%	100%	(2)
60/70	54.0%	100%	64%	55%	100%
50/100	55.0%	(2)	67%	55%	(2)
55/100	46.1%	85.3%	64%	45%	50%
60/100	37.8%	70%	64%	45%	50%
65/100	41.7%	56.7%	59%	50%	50%
70/100	31.9%	55%	59%	50%	50%
75/100	23.5%	55%	54%	55%	50%

(1) Current law subsidy levels do not include the 30% discount given to all producers for the 1999 crop year only with funds reserved from the disaster provisions of the FY1999 Omnibus Appropriations Act (P.L. 105-277).

(2) The Administration proposal and Cochran-Lincoln (S. 1108) would raise the level of free catastrophic coverage from the current 50/55 level to 60/70. This would preclude the need for farmers to buy 50/55 or 50/100 coverage, since these levels of coverage are lower than the proposed new CAT coverage level.

Source: USDA Risk Management Agency and sponsors of bills.

Administration Proposal. The Administration supports an increase in the premium subsidy for higher levels of coverage. It has proposed that the subsidy level for the 70/100 level of coverage be increased so that the farmer cost would be the same for 70/100 as it is currently for 65/100 coverage. For coverage above the 70/100 level, USDA has proposed that the government pay 50% of the additional cost of purchasing coverage beyond the 70/100 level. For example, if a farmer opts for 75/100 coverage, the government would pay 50% of the difference between the premium for 75/100 coverage and the premium for 70/100 coverage. USDA projects that the subsidy rate for these higher levels of coverage would rise to about 55% of premium. The Administration has also proposed that premiums for revenue insurance products be subsidized on a comparable basis with standard crop insurance and that the level of CAT coverage be raised from 50/55 to 60/70, with a continued 100% premium subsidy for CAT coverage.

House-Passed Bill (H.R. 2559). H.R. 2559 would increase the percentage share of the premium paid by the government for all levels of additional coverage. As passed by the House, H.R. 2559 would require the government to pay 67% of the premium for 50/100 coverage up to 55/100; a 64% subsidy for 55/100 up to 65/100; a 59% subsidy for 65/100 up to 75/100 coverage; a 54% subsidy for 75/100 up to 80/100; a 40.6% subsidy for 80/100 up to 85/100; and a 30.6% subsidy for 85/100 or greater, when available. The bill also would allow a producer to receive the same level of subsidy for a revenue insurance product as the level of subsidy provided for a basic crop insurance policy. (Current law requires producers to pay the full additional premium cost of buying up to revenue insurance.) The higher subsidy rates would take effect with the 2001 crop year.

A separate provision in H.R. 2559 would require USDA to review periodically the methodologies it uses for determining premiums, and adjust the premiums in time for the 2000 crop year if adjustments are necessary. Another provision would offer a farmer an additional premium discount, if the producer has a history of low crop losses relative to other producers of the commodity in the same area.

H.R. 2559 would continue to provide a 100% premium subsidy for CAT coverage at the 50/55 coverage level. The bill gives farmers the opportunity to obtain a higher level of CAT coverage than the 50/55 level, if the producer opts for Group Risk Plan (GRP) coverage. GRP, currently available in certain areas on certain crops, is based on county yields rather than an individual farmer's actual production level. It pays all insured farmers in an area when the entire area's production of an insured crop falls below a certain percentage of the normal production of the area. Because large area-wide losses occur less frequently than individual losses, premiums are generally lower for GRP than for regular crop insurance. The bill would allow a farmer to increase the level of CAT coverage from 50/55 to a higher level of GRP coverage, as long as the total premium subsidy is the same.

Senate Bills. In the Senate, several comprehensive bills to modify the crop insurance program include premium subsidy provisions. These include bills introduced by Senators Roberts and Kerrey (originally S. 529, but later superseded by S. 1580), and by Senators Cochran and Lincoln (S. 1108).

Among its many provisions, the Roberts-Kerrey bill (S. 1580) would invert the premium subsidy for levels of coverage higher than CAT coverage, so that the premium subsidy as a percentage of the total subsidy would be the highest for the higher levels of coverage. They would require USDA to pay 45% of the premium for levels of coverage greater than 50/100 but less than 65/100; 50% of the premium for coverage from 65/100 up to 75/100; and 55% of the premium for 75/100 coverage or higher. S. 1580 would also allow a farmer to receive a 5% additional premium subsidy for any level of coverage, if the producer adopts 2 of several risk management practices. Such practices include entering into a futures or option contract, forward pricing at least 20 percent of the value of a principal commodity produced on the farm, paying off a portion of farm debt, among other options.

S. 1108 addresses the perceived problems with the program as identified by Southern farmers, particularly producers of cotton and rice. For these commodities, participation in the crop insurance program is relatively low and farmers contend that premiums are too high for the coverage they receive. Rather than offer increased subsidies for higher levels of coverage, S. 1108 would provide a flat premium subsidy of 50% for all levels of additional coverage. Both Senate bills, like the House Agriculture Committee bill, mandate that revenue

insurance products be subsidized at the same rate as a standard crop insurance policy and retain the 100% subsidy rate for CAT coverage. However, S. 1108 concurs with the Administration request to raise the level of CAT coverage from the current 50/55 to 60/70. S. 1108 also would offer discounted premiums to any producer who has purchased insurance in the previous 5 consecutive years, but did not file a loss claim during the period. Both S. 1108 and S. 1580 also would require USDA to develop alternative methodologies for pricing insurance products and adopt the methodology that results in the lowest premium required of producers. Any adopted methodology must still allow the program to be operated on an actuarially sound basis (i.e., total premiums must cover anticipated losses.)

Senator Grams' bill (S. 357) would establish a 3-year pilot program for specific commodities in certain states beginning in 2000 and would require USDA to subsidize all levels of coverage between 65/100 and 85/100 at a rate of 31% of total premium.

Multiple-Year Crop Losses and Actual Production History

The level of crop yield coverage is viewed by farmers as one of the most critical features of the program, and a major determinant of whether a farmer will purchase insurance. In determining what a normal production level is for an insurable farmer, USDA requires the producer to present actual annual crop yields (usually stated on a bushel per acre basis) for the last 4 to 10 years. The simple average of a producer's annual crop yields over this time period then serves as the producer's actual production history (APH). If a farmer does not have adequate records, he can be assigned a transition yield (T-yield) for each missing year of data, which is based on average county yields for the crop.

A producer can insure a certain percentage of his APH, up to 75% in most regions, and as high as 85% in selected regions. If an insured farmer's actual yield falls short of his insured yield, the producer potentially can receive an indemnity (loss) payment. Farm groups in regions that have been stricken with multiple years of natural disasters in recent years (particularly the Northern Plains and Texas) have complained that the current system of calculating APH discriminates against them and causes them to be assigned crop yields that are below their true production potential. When producers are affected by multiple years of disasters the years of little or no harvested production tend to significantly reduce the producer's APH. These producers would like to see some accommodation made so that the producer's yield guarantee is not severely reduced by multiple-year crop losses. Moreover, some farmers have complained that a low APH prohibits them from purchasing adequate levels of insurance to cover their costs of production. Others question the logic of insuring crops on land vulnerable to high risk of losses.

Administration Proposal. Nothing in current law specifically requires USDA to adjust yields for multiple years of disasters. However, current USDA regulations prohibit a farmer's APH from falling more than 10% in any one year, nor can it fall any lower than 80% of the transition yield for certain major row crops. Also a producer's APH cannot rise more than 20% from one year to the next. The Administration has proposed that USDA be authorized to offer a new multi-year "umbrella" insurance product to complement single-year policies. USDA also has announced that it will examine alternatives to the current method of determining the yields used as the basis for coverage.

House-Passed Bill (H.R. 2559). As passed by the House, effective in the 2001 crop year, H.R. 2559 sets a floor under a farmer's past and future annual yields so that yields in any year would never fall below 60% of the transition yield for that commodity.

Senate Bills. The Roberts/Kerrey bill (S. 1580) also contains a provision that would require USDA to adjust APH for those affected by multi-year disasters. The bill defines a multi-year disaster as a loss to any producer who suffers a natural disaster in 3 of the most recent 5 years, which results in a cumulative reduction in APH of at least 25%. A producer who suffers a multi-year loss would be able to exclude one year of production history for each 5 years included in APH. If this exclusion caused a farmer's premium to rise, USDA would be required to pay any additional premium costs for the farmer. Producers who receive an exclusion would be permitted to have their APH rise each year without limit, until the APH reaches the level for the crop year preceding the first year of the multi-year disaster. The exclusion would sunset as soon as USDA makes available a subsidized policy that "adequately" insures against multi-year losses.

The Cochran-Lincoln bill (S. 1108) would set a floor under the insurable yield of all producers by prohibiting the yield in any year from dropping below 85% of the transition yield (which is the yield assigned by USDA to a producer who lacks production history.) Like S. 1580, if this higher level of coverage results in a higher premium cost, S. 1108 would require USDA to pay all of the additional premium costs.

A three-year pilot program within the Grams bill (S. 357) would allow a farmer to exclude one crop year from his production database, if the crop was produced in each of the last 5 years. The Baucus/Craig bill (S. 629) would allow a producer to exclude one year of production history for every 4 years of available data. S. 629 also would require USDA to offer a level of price coverage that is set no lower than the estimated cost of production for that commodity.

Livestock Coverage

In recent years, livestock producers have been faced with record supplies of red meat and poultry, contributing to depressed prices and income for livestock in general and hogs in particular. Traditionally, livestock has been a sector of production agriculture that has received a minimal amount of price and income support from the federal government. However, some groups have expressed interest in new authority for some type of subsidized revenue insurance product for livestock producers in conjunction with the federal crop insurance program. Current law gives USDA the discretion to determine whether a farm commodity is insurable. However, the statute specifically excludes livestock as an insurable commodity under the federal crop insurance program.

Administration and Legislative Proposals. The Administration has proposed that USDA be given the authority to offer revenue-based insurance products for livestock on a pilot basis, as proposed by the private sector and be given $50 million in mandatory funding for these insurance products. As amended on the House floor, H.R. 2559 would require USDA to conduct two or more pilot programs to evaluate the effectiveness of risk management tools for livestock farmers. Each pilot program would last up to three years, and would begin in FY2001 with annual spending limits of $20 million in FY2001, $30 million in FY2002, $40 million in FY2003, and $55 million in FY2004 and each subsequent

year. The Roberts/Kerrey bill (S. 1580) and a Daschle bill (S. 19) would strike the prohibition on livestock as an insurable commodity from current law. S. 1580 authorizes several new pilot insurance programs including a pilot revenue insurance program for hog and cattle producers in Iowa, which also would allow a participating farmer to insure the entire farm's revenue (including income from corn and soybeans) in one blanket policy. A separate pilot program for coverage of all currently noninsurable commodities (including livestock) also would be authorized to be conducted in areas at the discretion of the Secretary of Agriculture. S. 19 would mandate a pilot program for livestock revenue insurance. S. 1580 would permit but not require that USDA include livestock as an insurable commodity.

Private Sector Incentives

Private insurance companies are free to develop new risk management programs and submit them to USDA for approval to be reinsured under the federal crop insurance program. For example, private companies have developed some of the revenue insurance products that are now available on a pilot basis on various crops in certain areas. Currently, USDA is not authorized to reimburse the private companies for developing and maintaining these new products. Many companies claim that this lack of compensation has a negative effect on the number of new products developed by the private sector and the number of risk management tools available to farmers in general. Private entities will not engage in product development, they say, if the developer has no opportunity to recover its expenses. Private insurers also point out that newly developed and approved insurance products can be adopted immediately by any competitor without the competitor reimbursing the insurance company for its development costs, which they say further stymies product innovation.

Administration Proposal. The Administration has proposed that USDA be authorized to 1) reimburse private companies for the cost of any new successful products they develop; 2) contract with the private sector to develop new products for smaller crops; 3) reduce regulatory procedures for developing and updating policies; and 4) develop more pilot insurance programs with greater flexibility.

House-Passed Bill (H.R. 2559). Beginning in FY2001, the House-passed bill would require USDA to reimburse the research, development and maintenance costs of any private entity that develops a new insurance product. The entity could receive a payment for up to 4 years following approval, with the payment amount determined by USDA. Also under the bill, if any farm commodity is considered by USDA to be inadequately served by crop insurance, USDA can enter into a contract with a private entity to carry out research and development of insurance plans for that commodity. H.R. 2559 would allow USDA to spend up to $55 million annually for reimbursements, of which $10 million would be reserved for under-served commodities. Any entity that develops a new plan of insurance, but does not seek a reimbursement from the government, can receive a fee from any insurance provider that elects to sell the new plan of insurance.

H.R. 2559 also would give the private sector more representation and power on the Federal Crop Insurance Corporation (FCIC) Board, which is responsible for making policy decisions relating to the scope of the federal crop insurance program. Currently the administrator of USDA's Risk Management Agency serves as the manager of the FCIC board. The House-passed bill would remove the voting rights of the manager of the Corporation and would add a fourth farmer to the 9-voting-member Board. The bill also adds

the chief economist of USDA and a person with experience in regulating insurance as voting members, and requires the Chairman of the Board to be a non-Government employee.

Senate Bills. The Roberts-Kerrey bill (S. 1580) includes a fee structure that would allow companies that develop approved insurance products to be compensated by competitors who adopt their product. Beginning in 2000, any approved insurance provider that developed a product approved prior to January 1, 1999 would receive $2 per policy for the first 5 years, $1 for the next 3 years, and $0.50 for every year thereafter. For any product approved after January 1, 1999, the developing company could receive a fee, as determined by the provider who developed the plan and as approved by the FCIC Board.

The Cochran-Lincoln bill (S. 1108) states that insurance providers who develop new plans of insurance have the right to receive a fee from insurance companies that elect to sell that plan of insurance. S. 1108 allows any approved provider that develops a new insurance product after the date of enactment to determine what the fee should be, with the approval of the FCIC Board. The Board would collect the fee and distribute it to the developing company.

Like the House-passed bill, both S. 1580 and S. 1108 would remove voting rights from the Administrator of USDA's Risk Management Agency on the FCIC Board, add a representative from the insurance industry, and require the Chairman of the Board to be from the private sector. S. 1108 also would add two additional farmer representatives to the Board, while the House committee bill adds one farmer.

Also under both Senate bills, instead of RMA supervising the activities of the Federal Crop Insurance Corporation, RMA would be under the direction of the FCIC Board. A new USDA Office of Private Sector Partnership also would be created to make policy recommendations to the Board and to assume the responsibility of reinsuring the private companies, which the Board currently oversees.

Noninsured Crop Disaster Assistance Program (NAP) Changes

The Noninsured Crop Disaster Assistance Program (NAP) is a permanent disaster payment program administered by USDA's Farm Service Agency that is separate from the federal crop insurance program. The program was designed to complement the federal crop insurance program by offering direct disaster payments to producers who grow a crop that is not covered by the federal crop insurance program. NAP is intended to be a transitional program for those growers who are awaiting approval for coverage of their crop in their area and a more permanent assistance program to those who grow a crop that is not economically feasible to insure. In order to be eligible for a NAP payment, the area in which the producer grows a non-insurable crop must first experience a 35% loss of that crop. Once the area loss requirement is met, an individual producer can receive a payment similar to catastrophic coverage on an insured crop: 55% of the market price for the commodity on losses in excess of 50% of normal production (50/55).

Many producer groups argue that NAP has provided inadequate assistance to uninsurable producers since its inception in 1994. (Total annual payments have been less than $100 million each year.) They contend that the area loss requirement is too restrictive and even if a county becomes eligible, the payment rate is too low for individual farmers. The

FY2000 Consolidated Appropriations Act (P.L. 106-113) waived for one year the minimum area loss requirement of 35%, for any producer who farms in a region that has been declared a disaster area by either the President or the Secretary of Agriculture.

Administration Proposal. The Administration has recommended that NAP coverage be increased from the current 50/55 level to the same level it recommends for CAT coverage, 70% of market price for losses in excess of 40%, or, 60/70 coverage. The Administration has also proposed that the cost-effectiveness of replacing the area loss requirement with a Secretarial designation of eligibility be investigated.

House-Passed Bill (H.R. 2559). Effective in the 2001 crop year, H.R. 2559 would revise the income limitation for potential recipients of NAP payments. Under current law, a producer with gross revenues in excess of $2 million is ineligible for NAP payments. H.R. 2559 would make this provision less restrictive by basing income on "adjusted gross income" rather than "gross revenues." A provision in the subcommittee version of the bill would have allowed an individual producer to become eligible for a NAP payment if his acreage is located in a county that has been declared a disaster area by either the President or the Secretary of Agriculture. This provision was struck by the full committee because of budget constraints.

Senate Bills. The Baucus/Craig bill (S. 629) would eliminate permanently the area 35% minimum loss requirement, authorize payments of 100% of the market price instead of the current 55% on eligible crop losses, and require USDA to use Olympic averaging (dropping the highest year and lowest year) in determining a producer's normal crop yield. It would also require producers to pay a service fee of $50 per crop per county for a NAP payment to help defray some of the additional costs. The Roberts/Kerrey bill (S. 1580) would waive the 35% minimum loss requirement in any declared disaster area, or at the Secretary's discretion.

Budgetary Impact of Crop Insurance Legislation

One of the most controversial aspects of enhancing the crop insurance program involves the cost of any such changes. Estimating these costs are complicated by the ripple effects of some of the proposals. For example, increasing the premium subsidy for farmers will presumably increase farmer participation in the program, which will in turn increase the amount of federal subsidy going to the private insurance companies for their delivery costs. Also, greater farmer participation could likely mean higher total indemnity payments to farmers and potentially greater program losses for the government to absorb, especially if higher risk farmers are attracted to the program. The cost of adding livestock revenue insurance coverage is also difficult to measure, particularly if USDA is given authority to cover livestock without any program specifics. Since the value of livestock production accounts for roughly one-half of the value of all agricultural products marketed, the addition of livestock coverage alone could more than double the cost of the current program.

The FY2000 budget resolution (H.Con.Res. 69), adopted by Congress on April 15, 1999, created a reserve fund of $6 billion over a multi-year period to be used exclusively to fund the added costs of crop insurance modifications or any type of farm income assistance. The resolution permits this money to be spent in FY2001 through FY2009 and limits annual new spending to no more than $2 billion per year for FY2001-2004. None of the reserve fund can be spent on any legislation that increases spending in FY2000. Any new spending in

FY2000, or new spending in excess of $2 billion per year by FY2004, or $6 billion in total over 10 years, would have to be offset with reductions in other federal spending.

When the House-passed crop insurance bill was reported by the Agriculture Committee, it contained estimated new spending of $471 million in FY2000, mostly in the form of additional premium subsidy. Because the FY2000 budget resolution prohibits any of the $6 billion reserve fund to be spent in FY2000, the bill was revised prior to floor action to delay until the 2001 crop year all program enhancements that require higher federal expenditures, including the higher rate of premium subsidies and the enhanced coverage for multiple-year losses. The total cumulative cost of the bill through 2004 is approximately $6 billion.

Although the budget resolution prohibits the spending of any of the $6 billion reserve fund on crop insurance or income enhancement in FY2000, the FY2000 agriculture appropriations act (P.L. 106-78) contains $8.7 billion in emergency FY2000 spending for farmers to help them recover from low commodity prices. The package includes $400 million for crop insurance premium discounts and $1.2 billion in direct payments for farmers affected by a natural disaster. For more information, see CRS Report RS20416, *Emergency Farm Assistance in FY2000 Agriculture Appropriations Acts*.

LEGISLATION

H.Con.Res. 68 (Kasich)

Section 204 of the conference agreement on the FY2000 budget resolution creates a $6 billion reserve fund to be used exclusively for new spending on farm risk management or farm income assistance over the next 5 to 10 years, excluding FY2000, and not to exceed $2 billion per year between FY2001 and FY2004. The full House and Senate approved the conference agreement on April 14 and April 15, 1999, respectively.

H.R. 2559 (Combest)

Among its many provisions, the Agricultural Risk Protection Act of 1999 (as of August 2, 1999) would: 1) increase the premium subsidy for all levels of crop insurance beyond the catastrophic level; 2) place a floor under a producer's yield so that it does not fall below 60% of average county yields, or, no more than a 5% drop from year to year; 4) authorize pilot programs for livestock revenue insurance; and 5) restructure the Board of Directors of USDA's Federal Crop Insurance Corporation (FCIC) to allow the private sector to play a greater role in Board policymaking. Introduced July 20, 1999; referred to the Committee on Agriculture. Subcommittee on Risk Management markup completed on July 21. Full committee markup completed on August 3. Passed by voice vote in the House on September 29.

S. 19 (Daschle)

The Agricultural Safety Net and Market Competitiveness Act of 1999 is a comprehensive bill containing provisions that: 1) express the sense of the Senate that the federal crop insurance program should be modified to increase the number of eligible commodities as well as improve access to insurance products, make crop insurance more affordable, and protect against multi-year disasters; 2) remove the statutory restriction on livestock as an insurable commodity and establish a revenue insurance pilot program for livestock. Introduced January 19, 1999; referred to the Committee on Agriculture.

S. 357 (Grams)

Establishes a 3-year pilot program beginning in crop year 2000 in certain states that provides an increase in the premium subsidy for higher rates of coverage, an opportunity for producers to insure the whole farm unit, and the option for a producer to exclude the lowest production year from the producer's actual production history. Within 90 days after the program expires, USDA would be required to report to the House and Senate Agriculture Committees on the results of the program. Introduced February 3, 1999; referred to the Committee on Agriculture.

S. 629 (Baucus/Craig)

The Crop Insurance Improvement Act of 1999 1) requires USDA to establish a level of crop insurance price coverage that is set no lower than the estimated cost of production for that commodity; and 2) allows a producer to exclude one year of actual production history for every 4 years of available data. The bill also modifies the Noninsured Assistance Program (NAP) by 1) removing the current area loss requirement of 35% as a prerequisite for an individual producer being eligible for a NAP payment; 2) paying producers 100% of the market price instead of the current 55% on eligible crop losses; 3) requiring USDA to use Olympic averaging (dropping the highest year and lowest year) in determining a producer's normal crop yield; and 4) requiring producers to pay a service fee of $50 per crop per county for a NAP payment. Introduced March 16, 1999; referred to the Committee on Agriculture.

S. 1109 (Cochran/Lincoln)

The Crop Insurance Equity Act of 1999 would: 1) provide a flat 50% premium subsidy for all levels of additional crop insurance coverage; 2) increase the level of catastrophic (CAT) coverage from the current 50/55 level (payment of 55% of the market price for the commodity for losses in excess of 50%) to 60/70 (which would pay 70% of the market price on losses after a 40% deductible); 3) require USDA to develop alternative ways of rating crop insurance plans, and adopt the methodology that results in the least cost to the farmer; 4) provide further premium discounts to producers who have had insurance coverage for 5 consecutive years without a claim; 5) prohibit any producer's insurable yields from falling below 85% of transition (average county) yields; 6) provide additional private sector participation in the policymaking Board of the Federal Crop Insurance Corp., and place USDA's now-independent Risk Management Agency under the direction of FCIC. Introduced May 24, 1999; referred to the Committee on Agriculture.

S. 1401 (Graham/Mack)

Addresses the concerns of specialty crop growers (fruits, vegetables, nuts, greenhouse and nursery plants, timber and turfgrass) with respect to crop insurance coverage. Authorizes a "specialty crop administrator", a new non-profit corporation empowered to develop new insurance products for specialty crops. Requires that at least one FCIC Board member represent specialty crop production. Introduced July 20, 1999; referred to the Committee on Agriculture.

S. 1580 (Roberts/Kerrey)

The Risk Management for the 21st Century Act makes several permanent comprehensive modifications to the federal crop insurance program by: 1) increasing the premium subsidy from current levels for the highest levels of coverage; 2) allowing producers who have suffered multiple years of disasters to exclude one year from their actual production history for a limited time; 3) authorizing pilot revenue insurance programs for livestock; 4)

restructuring USDA's Federal Crop Insurance Corporation's Board of Directors to allow the private sector to play a greater role in Board policymaking; and 5) creating a fee system that would allow private insurance companies that develop new insurance products to be compensated for their development costs when competitors adopt these products. Introduced September 13, 1999; referred to the Committee on Agriculture.

S. 1666 (Lugar)

The Farmers' Risk Management Equity Act allows a farmer to receive a direct payment if the farmer adopts two of a number of specified risk management tools, including the purchase of a crop insurance policy and participation in the futures market. Total payments would be $5 billion over a four-year period, and would be based on the farmer's historical value of production. Introduced September 29, 1999; referred to the Committee on Agriculture.

For Additional Reading

CRS Report 97-572. *Managing Farm Risk in a New Policy Era*, by Ralph M. Chite and Mark Jickling.

CRS Report 98-952. *The Emergency Agricultural Provisions in the FY1999 Omnibus Appropriations Act,* by Ralph M. Chite.

CRS Report 98-682. *Farm Disaster Assistance: USDA Programs*, by Ralph M. Chite.

CRS Report RL30201, *Appropriations for FY2000: U.S. Department of Agriculture and Related Agencies,* co-ordinated by Ralph M. Chite.

CRS Report RS20416, *Emergency Farm Assistance in FY2000 Agriculture Appropriations Acts*, by Ralph M. Chite