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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

On May 25, 2000, the House and Senate gave final approval to legislation (H.R. 2559) that will reduce significantly the farmer cost of acquiring a crop insurance policy. The President is expected to sign the measure soon. The conference agreement will require $8.2 billion in new federal spending for the crop insurance program over the next 5 years, in an attempt to attract more farmers into the program and lessen dependence on ad hoc disaster assistance.

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 encouraged consideration of additional modifications. Some were opposed to providing any new funding to crop insurance because of concerns that such subsidies encourage farmers to overproduce and 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 identified a number of factors that they perceive inhibit participation.

The approved conference agreement on H.R. 2559 addresses many of these perceived problems. The vast majority of the new spending authorized by the bill will be used to increase the portion of the premium paid by the government on behalf of the producer for coverage higher than the CAT level, and to subsidize a portion of the additional cost of revenue insurance products for the first time.

Among its many other provisions, the conference agreement also provides improved coverage for farmers affected by multiple years of natural disasters; authorizes pilot insurance programs for livestock farmers, gives the private sector greater representation in policymaking; and eases eligibility requirements for a permanent disaster payment program for noninsurable farmers.

The final FY2001 budget resolution (H.Con.Res. 290) served as the source of funds for the new spending required by the crop insurance conference agreement. The resolution permitted new agricultural program spending of $8.2 billion over the FY2001-05 period for modifications to the federal crop insurance program. Separately, H.Con.Res. 290 also contained a reserve fund of $7.14 billion to provide emergency farm financial assistance for FY2000 and FY2001, in response to continued low farm commodity prices. A separate title (Title II) authorizing this funding was included in the conference agreement on H.R. 2559.

## Most Recent Developments

*On May 25, 2000, the House and the Senate gave final approval to the conference agreement (H.Rept. 106-639) on a comprehensive federal crop insurance enhancement bill (H.R. 2559). The President is expected to sign the measure. Among its many provisions, the agreement offers higher levels of premium subsidy to farmers participating in the federal crop insurance program, and improves insurance coverage when a farmer is affected by multiple years of disasters. The projected cost of the crop insurance legislation is $8.2 billion over 5 years, as permitted by the FY2001 budget resolution (H.Con.Res. 290). A separate title (Title II) within the conference agreement authorizes an estimated $7.1 billion in emergency financial assistance to farmers in FY2000 and FY2001.*

## 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 farm commodity prices are low, as they have been 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.)

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.

**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 |
| 1999 | (80,338) | 1,295,454 [e] | 494,836 | 66,021 | 1,775,973 |
| FY1981-99 Total [f] | 2,975,588 | 6,842,560 | 4,396,311 | 1,680,981 | 15,895,440 |

[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] Premium subsidy for 1999 includes a $357.4 million premium discount provided on an emergency basis in the FY1999 Omnibus Appropriations Act (P.L. 105-277)

**Source:** USDA Risk Management Agency

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* (CRS Report 98-682).

## Pros and Cons of Crop Insurance Enhancement

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. For the most part, the strongest supporters of crop insurance enhancements are producers in the Plains states and other regions that are prone to drought and other recurring disasters.

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.) 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.

## A Brief Legislative History of Crop Insurance Enhancement Legislation

Over the last several years, 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 in 1999.

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, 1999. 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 "Crop Insurance and the Budget Resolution" below.)

In the Senate, several crop insurance bills, including S. 1580 (Roberts/Kerrey), were introduced to address many of the perceived problems with the federal crop insurance program. S. 1580 would have made modifications to the crop insurance program similar to H.R. 2559. Senate Agriculture Committee Chairman Richard Lugar, who strongly opposed S. 1580, stated that increased subsidies for crop insurance are not the most efficient way to encourage farmers to manage their risk. Instead, he introduced legislation (S. 1666) that would have made a direct payment to any insurable producer who adopts two of several risk management strategies. A lack of consensus between supporters of S. 1580 and S. 1666 led to a several month delay in consideration of a markup bill. At a March 2, 2000 markup, Senator Lugar offered a chairman's mark that blended the primary component of his bill with that of the Roberts/Kerrey bill. Among its many provisions, the chairman's mark would have given farmers a choice between receiving an additional crop insurance premium subsidy or receiving a direct payment in return for adopting two risk management strategies, such as purchasing a crop insurance policy or entering into a futures or option contract.

As a substitute to the chairman's mark, Senators Roberts and Kerrey offered a modified version of their bill as a substitute, which was adopted by the full committee by a 10-8 vote on March 2, 2000, and subsequently numbered S. 2251. S. 2251, as amended on the Senate floor was adopted by the full Senate on March 23, 2000. The Senate-passed measure is similar to the House-passed bill in that most of the new spending would increase the government subsidy and reduce the farmer cost of purchasing an insurance policy. Additionally, S. 2251 reserves $500 million over a 3-year period for direct payments to producers who adopt two of several prescribed risk management strategies in lieu of receiving a crop insurance subsidy. A manager's amendment to S. 2251 was adopted on the Senate floor. Among its many provisions, it addresses some additional concerns of states that have a low participation rate in the federal crop insurance program. Conference action on the two measures was completed on May 25, 2000, with the House approving the agreement by voice vote and the Senate passing the measure by a vote of 91-4. (See "Major Provisions in the Crop Insurance Conference Agreement" below for more information.)

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 nearly 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 did not offer 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 USDA testimony before Congress [http://www.act.fcic.usda.gov/pubafrs/ar/house_031099.html]. Additional crop insurance proposals were subsequently offered by the Administration as part of its safety net initiative released with its FY2001 budget request on February 7, 2000. Among the major risk management provisions in the initiative are anticipated legislative proposals to 1) extend to the 2001 crop year the 30% discount already offered on an emergency basis for crop insurance premiums for 1999 and 2000; 2) improve insurance coverage for farmers affected by multiple years of disasters; 3) establish a pilot program for livestock insurance coverage; and 4) loosen eligibility requirements for direct payments provided through the Noninsured Assistance Program (NAP).

## Major Provisions in the Crop Insurance Conference Agreement

After more than one year of debate and legislative consideration on how to improve participation in the crop insurance program, and whether federal involvement in the program should be further enhanced, Congress completed consideration of the conference agreement on a crop insurance bill (H.R. 2559) on May 25, 2000. The President is expected to sign the measure soon. (See "A Brief Legislative History of Crop Insurance Enhancement Legislation" above for information on the original House- (H.R. 2559) and Senate-passed bills (S. 2536)).

The conference agreement increases spending on the federal crop insurance program by $8.18 billion over the next 5 years (FY2001-05), with funding made possible by a reserve fund created by the FY2001 budget resolution (see "Crop Insurance and the Budget Resolution" below for more details.)

Most of the new spending (nearly $6.7 billion over 5 years) in the measure will allow USDA to increase significantly the portion of the premium paid by the federal government, and to subsidize revenue insurance products at the same rate as regular crop insurance. An increase in the premium subsidy means that the participating farmer's out-of-pocket costs for purchasing insurance will decline in tandem.

Other major risk management provisions in the bill include: 1) an adjustment of producer's yields so that insurance coverage does not decline drastically when a producer is affected by multiple years of disasters; 2) an expansion of USDA authority to conduct pilot insurance programs, including two new pilot livestock insurance programs and an expansion of the existing dairy options pilot program; 3) new authority for private insurers who develop newly adopted insured products to be reimbursed for their research and development costs, and for the industry to have greater representation on the Federal Crop Insurance Corporation Board; and 4) the elimination of a minimum area-loss requirement for eligibility in the noninsured assistance payment (NAP) program, which makes direct payments to farmers who grow a non-insurable crop that is affected by a natural disaster.

The following sections highlight these major issues, and provides more detail on how they were addressed in the conference agreement on H.R. 2559.

## Premium Subsidy

**Background.** 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 approximately $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 recent years, the government on average has 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 a farmer 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 argued 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.

**Conference Agreement.** As shown in Table 2 below, the approved conference agreement on the crop insurance bill increases the percentage share of the premium paid by the government for all levels of additional coverage. The higher subsidy takes effect with the 2001 crop year. The share of the premium to be paid by the government under the agreement closely resembles the provisions in the original House-passed bill. Although the percentage of premium paid by the government will continue to decline as participants move to higher levels of coverage, the government contribution to premium costs will significantly increase for all levels of coverage under the conference agreement, particularly for the highest levels of coverage. For example, the share of the premium paid by the government will rise from 42% to 59% for 65/100 coverage, and from 24% to 55% for 75/100 coverage. Additionally, the conference agreement requires USDA to subsidize revenue insurance products (or any new, approved plans of insurance) at the same rate as the level of subsidy provided for a basic crop insurance policy. (Current law requires producers to pay the full additional premium cost of purchasing revenue insurance.)

When compared with current law, the premium subsidy structure in the conference agreement (including the new subsidy for revenue insurance) will cost the government an additional $6.7 billion over 5 years, according to Congressional Budget Office (CBO) estimates. This amount accounts for more than 80% of the $8.2 billion total cost of the crop insurance enhancement legislation. To slightly defray the cost of the additional subsidies, the agreement requires that a new administrative fee of $30 per crop per county be assessed to any producer who purchases additional crop insurance coverage beyond the catastrophic level.

**Table 2. Comparison of Premium Subsidies:**
**Conference Agreement vs. Current Law and House and Senate Bills**
Government-Paid Portion of Premium as a Percent of Total Premium

| Coverage Level | Current Law (1) | H.R. 2559 (House-Passed) | S. 2251 (Senate-Passed) | Conference Agreement |
|---|---|---|---|---|
| 50/55 | 100% | 100% | 100% | 100% |
| 50/100 | 55% | 67% | 60% | 67% |
| 55/100 | 46% | 64% | 45% | 64% |
| 60/100 | 38% | 64% | 45% | 64% |
| 65/100 | 42% | 59% | 50% | 59% |
| 70/100 | 32% | 59% | 50% | 59% |
| 75/100 | 24% | 54% | 55% | 55% |
| 80/100 | 17% | 41% | 38% | 48% |

(1) For the last two crop years the actual premium subsidy has been higher than what is shown in the first column of percentages. Not included above is a further 30% discount given to all producers for the 1999 crop year and a 25% discount in 2000, under the authority of various emergency supplemental acts.

**Source:** USDA Risk Management Agency and sponsors of bills.

The conference agreement retains the current 100% premium subsidy for catastrophic (CAT) coverage at the 50/55 level of coverage. However, the administrative fee for CAT coverage will rise from the current $60 per insured crop, to $100, which according to CBO will cost farmers an additional $60 million over 5 years. The final agreement also 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 conference agreement allows 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.

One of the major differences between the original House (H.R. 2559) and Senate (S. 2251) crop insurance bills, as originally passed by their respective chambers, was that the Senate-passed bill would have reserved approximately $360 million for a "choice of risk management options" pilot program, which was strongly supported by Senate Agriculture Committee Chairman Richard Lugar. This provision was not adopted by conferees. Under the pilot program, a producer could have chosen to receive either a subsidized crop insurance policy, or forego the subsidy and instead, receive a direct federal payment, if the farmer agreed to adopt two of several eligible risk management practices. This pilot program was supported by Senators from states with a traditionally low participation rate in the crop insurance program, primarily in the East.

## Multiple-Year Crop Losses and Actual Production History

**Background.** 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.

**Conference Agreement.** Effective in the 2001 crop year, the conference agreement sets a floor under a farmer's past and future annual yields so that yields in any year cannot fall below 60% of the transition yield for that commodity. This means that even if a producer has a total crop loss in any year, the yield used for that year to calculate the producer's APH will not be lower than 60% of the historical average production for the region. This provision was contained in the original House-passed bill, while the Senate bill would have allowed a producer to exclude one poor year of production history for each 5 years included in APH. The estimated federal cost of the 60% floor in the conference agreement is $788 million over 5 years, according to the Congressional Budget Office.

No provision 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 supports such enhancements to the program that assist a producer affected by multiple years of disaster.

## Livestock Coverage

**Background.** 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.

**Conference Agreement.** The conference agreement requires USDA to conduct two or more pilot programs to evaluate the effectiveness of risk management tools for livestock farmers. The pilot programs can provide livestock producers with protection from the financial risks of price and income fluctuation, or from production losses. The conference agreement gives USDA the authority to provide reinsurance to private companies offering livestock insurance, or to subsidize a livestock producer's purchase of a futures or options contract. USDA is given the authority to determine which counties are to be included in a pilot program. The livestock pilot programs would begin in FY2001 with annual spending limits of $10 million for each of FY2001 and FY2002, $15 million in FY2003, and $20 million in FY2004 and each subsequent year, for a projected 5-year total cost of $75 million. The Administration supports giving USDA authority to offer revenue-based insurance products for livestock on a pilot basis.

The conference agreement also allows USDA to conduct pilot risk management programs for other farm commodities as a way of testing whether any new program is suitable for the marketplace and addresses the needs of producers. Another provision in the agreement expands the existing options pilot program from 100 to 300 counties. The dairy options pilot program was the first and only such program developed by USDA under its 1996 farm bill authority to conduct options pilot programs. The program educates and subsidizes dairy farmers in their use of the futures market as a tool for managing price risk.

## Private Sector Incentives

**Background.** 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.

**Conference Agreement.** Beginning in FY2001, the conference agreement requires USDA to reimburse the research, development and maintenance costs of any private entity that develops a new (or existing) insurance product. The entity could receive a payment for up to 4 years following approval, with the payment amount determined by USDA. After the 4-year payment period, the insurance provider responsible for maintaining the policy can develop and charge a fee to any other insurance provider who elects to sell the policy. The amount of the fee must be approved by USDA's Federal Crop Insurance Corporation Board. Also under the conference agreement, 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.

The conference agreement authorizes USDA to spend not more than $10 million in each of FY2001 and FY2002, and $15 million in subsequent years on reimbursements for research and development costs of new policies. Of this amount, not more than $5 million each fiscal year can be used for underserved states.

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.

The conference agreement also 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 chief executive officer of the FCIC board. The conference agreement removes the voting rights of the manager of the Corporation and would add a fourth farmer to the 9-voting-member Board. The bills also add the chief economist of USDA to the Board, and allows the Board to select its own chairman. USDA had expressed concern that these provisions would lead to weakened government oversight of the crop insurance program.

### Noninsured Assistance Program (NAP) Changes

**Background.** 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. Under current law, 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.

**Bill Comparison.** Under the conference agreement, the minimum area loss requirement is eliminated as a prerequisite for receiving a NAP payment. Consequently, any noninsurable producer can receive a NAP payment as long as the individual producer has a minimum loss requirement of 50%. The agreement also institutes a new administrative fee that requires a potential recipient of NAP payments to pay a $100 per crop administrative fee (which can be waived for financial hardship cases). As part of its safety net initiative, the Administration supports replacing the minimum area loss requirement with a Secretarial designation for eligibility. The net cost of eliminating the area loss trigger, offset by the new $100 administrative fee, is estimated by CBO at $482 million over 5 years.

## Crop Insurance and the Budget Resolution

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 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 legislative modifications to federal risk management programs, or for any type of farm income assistance. This reserve fund served as the budget parameters for crop insurance enhancement legislation as it was being considered by their respective chambers. The FY2001 budget resolution (H.Con.Res. 290), as adopted by both chambers on April 13, 2000, increased the amount available for new crop insurance spending from $6 billion over 4 years to $8.18 billion over 5 years (FY2001-05), thus giving conferees more available funding as they worked out the differences between the two crop insurance bills.

Separately, H.Con.Res. 290 also contained a reserve fund of $7.14 billion ($5.5 billion in FY2000 and $1.64 billion in FY2001) that can be used exclusively for providing emergency financial assistance to farmers to help them recover from continued low farm commodity prices. In order for the funds to be made available, the House and Senate Agriculture Committees had to report authorizing legislation by the end of June. Instead of reporting separate legislation, the two committees agreed to include authorizing legislation for the $7.14 billion in a separate title (Title B) of the conference agreement on crop insurance. For more on this assistance, see CRS Report RL30501, *Appropriations for FY2001:USDA and Related Agencies* and CRS Issue Brief IB10043, *Farm Economic Relief: Issues and Options for Congress*.

## 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.Con.Res. 290 (Kasich)**

The FY2001 budget resolution increases the baseline budget for mandatory spending within the agriculture function of the budget (function 350) by $1.42 billion in FY2001 and $8.18 billion over 5 years (FY2001-2005), in order to allow for funding for crop insurance enhancement legislation. This increase in the budget baseline precludes the need for the reserve fund created by H.Con.Res. 68, above. The full House and Senate approved the conference agreement to H.Con.Res. 290 on April 13, 2000.

**H.R. 2559 (Combest)**

The conference agreement on the Agricultural Risk Protection Act of 2000: 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; 3) liberalizes the eligibility requirements for the noninsured assistance program (NAP); 4) authorizes and funds pilot insurance programs for livestock and other noninsured commodities; and 5) restructures 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, 1999. Full committee markup completed on August 3, 1999 (H.Rept. 106-300). Passed by voice vote in the House on September 29, 1999. Comparable bill (S. 2251) was marked up by the Senate Agriculture Committee on

March 2, 2000; reported to the Senate, without report on March 20, 2000. Passed the Senate on March 23, 2000 by a 95-5 vote. Senate subsequently passed H.R. 2559 on March 23, substituting the text of S. 2251 for the text of the House-passed bill. The conference agreement (H.Rept. 106-639) was filed on May 24, 2000. Conference measure passed both the House (voice vote) and Senate (91-4) on May 25, 2000.

## 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 RL30501, *Appropriations for FY2001: 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

CRS Issue Brief IB10043, *Farm Economic Relief: Issues and Options for Congress*, by Geoffrey Becker and Jasper Womach.