Order Code RL34207

CRS Report for Congress

Crop Insurance and Disaster Assistance: 2007 Farm Bill Issues

October 15, 2007

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Prepared for Members and Committees of Congress

Congressional Research Service

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Summary

The federal government has relied primarily on two policy tools in recent years to help mitigate the financial losses experienced by crop farmers as a result of natural disasters — a federal crop insurance program and congressionally mandated *ad-hoc* crop disaster payments. Congress has made several modifications to the crop insurance program since the 1980s, in an effort to forestall the demand for supplemental disaster payments. Although the scope of the crop insurance program has widened significantly over the past 25 years, the anticipated goal of crop insurance replacing disaster payments has not been achieved.

The federal crop insurance program is permanently authorized and hence does not require periodic reauthorization in an omnibus farm bill. However, modifications to the crop insurance program are being discussed in the context of the omnibus 2007 farm bill currently before Congress. Some policymakers have expressed interest in expanding the crop insurance program and/or complementing it with a permanent disaster payment program. Others view the crop insurance program as a potential target for program cost reductions, and propose using these savings to fund new initiatives in various titles of the farm bill.

The Administration's farm bill proposal contains several crop insurance recommendations that it claims will enhance participation; address issues of waste, fraud and abuse; reduce costs; and reduce the need for emergency supplemental disaster payments. The Administration is opposed to a permanent disaster payment program, and contends that its proposed supplemental crop insurance coverage for the deductible portion of a policy would help preclude the need for supplemental disaster payments.

The House-passed version of the farm bill (H.R. 2419) contains several revisions to the crop insurance program, most of which are cost-saving measures. Farmers would be required to pay higher fees for catastrophic coverage and participating insurance companies would see smaller reimbursements for their operating expenses and would be required to share more of their potential underwriting gains with the government.

To date, the Senate Agriculture Committee has not yet marked up its version of the 2007 farm bill. Meanwhile, the Senate Finance Committee approved legislation that, among its many provisions, would authorize a permanent trust fund to make agricultural disaster payments available on an ongoing basis over the life of the next farm bill. According to CBO, the program would cost $5.1 billion over five years, which is approximately equal to the annual average amount of *ad-hoc* disaster payments that have been provided by Congress over the past 20 years.

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Agriculture is generally viewed as an inherently risky enterprise. Farm production levels can vary significantly from year to year and by location, primarily because farmers operate at the mercy of nature, and frequently are subjected to weather-related and other natural disasters. Since the Great Depression, policymakers have decided that the federal government should absorb some portion of the weather-related production losses that otherwise would depress farm income and could alter farmers' decisions about what to produce in some high-risk locations.

Federal crop insurance is the primary ongoing crop loss assistance program. It is permanently authorized by the Federal Crop Insurance Act, as amended (7 U.S.C. 1501 *et seq*.), and is administered by the U.S. Department of Agriculture's Risk Management Agency (RMA). This is complemented with the Non-Insured Assistance Program, administered by the Farm Service Agency (FSA), which is available to producers not offered insurance coverage. Lack of insurance availability occurs in locations where there is insufficient production history to determine actuarial risks of a crop or in regions where production of a specific commodity is relatively small. Following a widespread and severe drought in 1988, Congress approved a large *ad hoc* disaster assistance program to supplement the ongoing disaster programs. Such *ad hoc* assistance subsequently has became routine.

For more information on currently available agricultural disaster assistance, see CRS Report RS21212, *Agricultural Disaster Assistance*.

Crop Insurance Program Design and Operation

Federal crop insurance policies are marketed and serviced by private insurance companies. In purchasing a policy, a producer growing an insurable crop may select a level of crop yield and price coverage and pay a portion of the premium, which increases as the levels of yield and price coverage rise. The remainder of the premium is covered by the federal government. Coverage is made available through various insurance products, including revenue insurance, which allows a participating producer to insure a target level of farm revenue rather than just production levels. According to the USDA, the federal crop insurance program provided coverage in 2006 to over 100 crops covering more than three-fourths of planted acreage in the country. Although the list of covered commodities has grown in recent years, 80% of total policy premiums (and federal subsidies) are accounted for by just four commodities — corn, soybeans, wheat, and cotton.

Table 1. Government Cost of Federal Crop Insurance

(millions of dollars)

Fiscal Year	Program Losses or (Gains)[a]	Federal Premium Subsidy	Private Company Admin. Expense Reimbursements	Other Costs[b]	Total Gov't. Cost
1981	97	47	0	105	**248**
1982	(60)	91	18	110	**160**
1983	147	64	26	97	**334**
1984	211	98	76	102	**487**
1985	216	100	107	98	**521**
1986	216	90	101	97	**504**
1987	55	73	107	73	**309**
1988	609	103	155	78	**945**
1989	400	190	266	88	**945**
1990	234	213	272	87	**806**
1991	247	196	245	84	**772**
1992	232	197	246	88	**764**
1993	750	197	250	105	**1,303**
1994	(127)	247	292	78	**489**
1995	188	774	373	105	**1,440**
1996	88	978	490	64	**1,621**
1997	(373)	945	450	74	**1,096**
1998	(75)	940	427	82	**1,374**
1999	(74)	1,295	495	66	**1,783**
2000	196	1,353	540	86	**2,175**
2001	725	1,707	648	83	**3,163**
2002	1,182	1,513	656	114	**3,466**
2003	822	1,873	743	150	**3,589**
2004	(303)	2,387	899	142	**3,125**
2005	(591)	2,368	782	139	**2,698**
2006	(298)	2,782	960	126	**3,571**

Source: USDA Office of Budget and Program Analysis. Totals may not add due to rounding.

a. The difference between total premiums (farmer and government paid) and total indemnity payments for crop losses, plus or minus any private company underwriting losses or gains.

b. Other costs primarily include federal salaries of USDA's Risk Management Agency and beginning in 2002, various research and development initiatives mandated by ARPA of 2000 (P.L. 106-224).

Because the program is not subject to periodic reauthorization, major changes to the crop insurance program usually are not addressed in the context of an omnibus farm bill. Over the past 25 years, the program has been subject to three major legislative enhancements (in 1980, 1994, and 2000),[1] each of which has pumped additional federal dollars into the program in order to enhance farmer participation levels in anticipation of precluding the demand for *ad hoc* disaster payments.

Since the last major modification in 2000, the federal subsidy to the crop insurance program has averaged about $3.25 billion per year, up from an annual average of $1.1 billion in the 1990s and about $500 million in the 1980s. Nearly two-thirds of the current federal spending is used to subsidize insurance policy premiums, and the balance primarily covers the government share of program losses and reimburses participating private insurance companies for their administrative and operating expenses. (See **Table 1**.)

Although the scope of the program has widened significantly over the past 25 years, the anticipated goal of crop insurance replacing disaster payments has not been achieved. In virtually every crop year since 1988, Congress has provided *ad hoc* disaster payments to farmers with significant weather-related crop losses. These have been made available primarily through emergency supplemental appropriations, and, until recently, regardless of whether a producer had an active crop insurance policy. The exception to the historical pattern is the FY2007 supplemental appropriations act (P.L. 110-28), which provided an estimated $1.5 billion in crop disaster payments for 2005, 2006, or early 2007 crop losses, but only to those producers who held an active crop insurance policy or enrolled in the noninsured assistance program in the year of the crop loss.[2]

Since FY1989, total disaster payments have amounted to more than $20 billion, or just over $1 billion per year. Over the past six years (FY2001-FY2006), the federal cost of the crop insurance program combined with *ad hoc* supplemental disaster payments has averaged $4.5 billion per year. (See **Figure 1**.)

For a summary of all agricultural disaster assistance provided by Congress since 1988, see CRS Report RL31095, *Emergency Funding for Agriculture: A Brief History of Supplemental Appropriations, FY1989-FY2007*.

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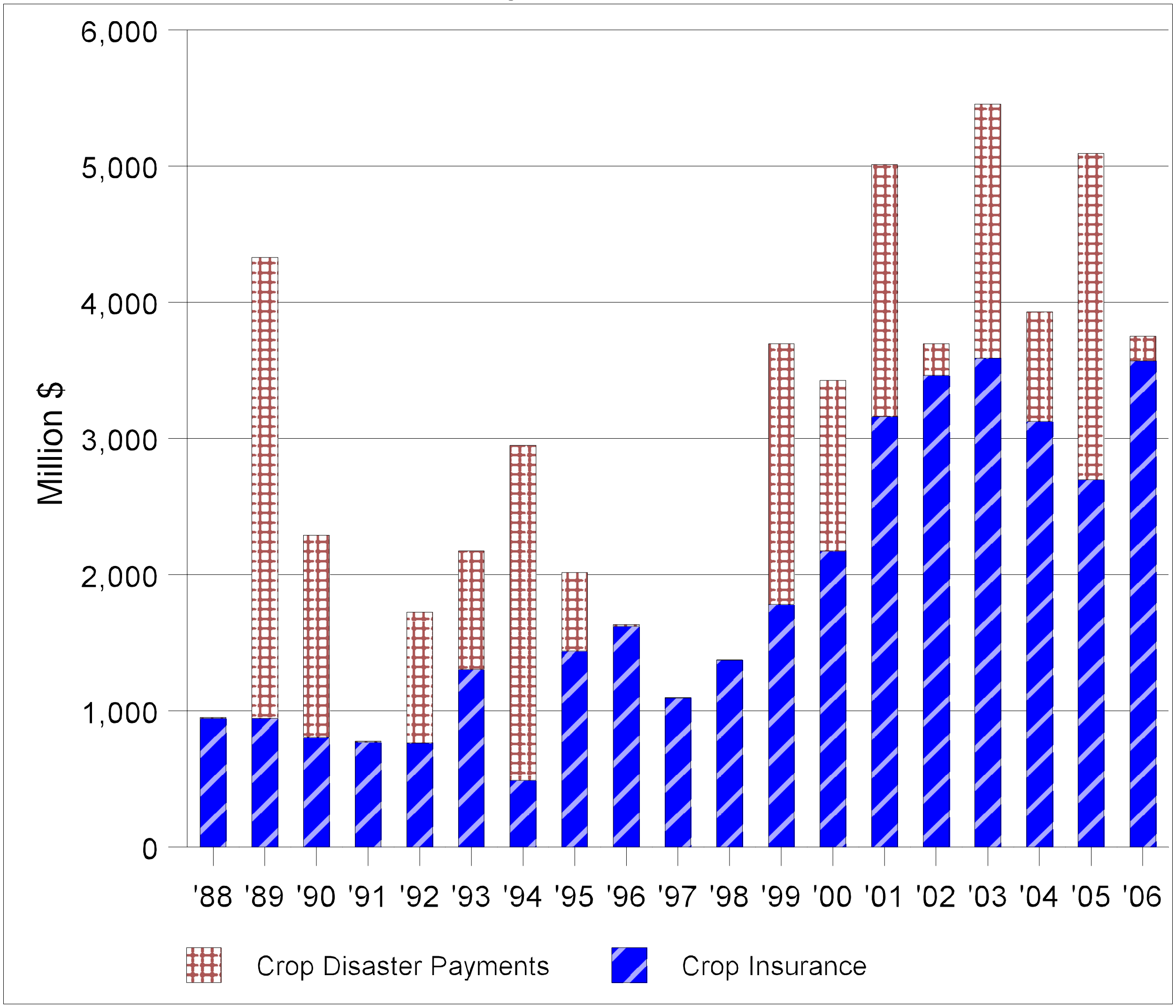
[1] Federal Crop Insurance Act of 1980 (P.L. 96-365), Federal Crop Insurance Reform Act of 1994 (P.L. 103-354), Agriculture Risk Protection Act (ARPA) of 2000 (P.L. 106-224). For information on ARPA of 2000, see CRS Report RL30739, *Federal Crop Insurance and the Agriculture Risk Protection Act of 2000 (P.L. 106-224)*.

[2] This assistance was provided in Title IX, Section 9001 of the FY2007 Iraq War Supplemental Act (P.L. 110-28). The projected spending of $1.5 billion for 2005, 2006 and early 2007 crop losses will be made in FY2008. For a description of this and other types of agricultural assistance made available in P.L. 110-28, see CRS Report RS21212, *Agricultural Disaster Assistance*.

Figure 1. Crop Insurance and Disaster Payments: Total Federal Cost, By Fiscal Year



Source: Primary data are from USDA's Table 35, CCC Net Outlays by Commodity & Function for disaster payments, and USDA's Office of Budget & Program Analysis for crop insurance.

Current Issues

Reducing Crop Insurance Program Costs. Although crop insurance is sold and serviced by private insurance companies, the federal government absorbs a large portion of program losses and reimburses the companies for their administrative and operating (A&O) expenses. Loss sharing and A&O reimbursements currently are spelled out in a Standard Reinsurance Agreement (SRA) between USDA and the private companies.[3] The Administration and others contend that the private insurance companies should be required to absorb more of

[3] For more background and for the text of the SRA, see [http://www.rma.usda.gov/pubs/ra/].

the program losses, and that the reimbursement rate for company A&O expenses needs to be reduced as a means of reducing federal costs. Under the SRA, the reimbursement rate for A&O expenses currently averages about 22% to 24% of total premiums. Proponents for change point out that A&O reimbursements to the companies have doubled over the last seven years (see **Table 1**), mainly because farmers have been buying up to higher levels of insurance coverage, causing total premiums to rise. Since A&O reimbursements are based on a percentage of total premiums, the Administration contends that the companies are being overcompensated for their expenses. The private crop insurance companies contend that any reductions in their A&O reimbursement would negatively impact the financial health of the crop insurance industry and possibly jeopardize the delivery of crop insurance, particularly in high-risk areas.

Permanent Disaster Payments. Some policymakers want to make permanent in the farm bill some level of disaster payments to supplement the crop insurance program. Supporters say that ongoing farm disaster programs do not adequately address emergency needs when a major disaster strikes and that USDA should have at its disposal a permanent source of disaster funds in the same manner as the Federal Emergency Management Administration (FEMA). Questions in the debate include how such a program would be funded given current budget constraints, and whether the permanent availability of disaster payments would adversely affect participation in the crop insurance program, and possibly encourage production on high-risk lands.

Waste, Fraud, and Abuse. For many years, policymakers have been concerned about waste, fraud, and abuse within the federal crop insurance program. The Agricultural Risk Protection Act (ARPA) of 2000 (P.L. 106-224) contained several provisions that were designed to enhance USDA's recognition of and response to challenges to program compliance and integrity. In response to the ARPA requirements, USDA used "data mining" techniques to compile an annual list of producers who either exhibit high loss ratios (i.e., high indemnity payments relative to total premiums), high frequency and severity of losses, or who are suspected of poor farming practices that might contribute to production losses. USDA estimates that the use of the spot-check list has prevented between $70 million and $110 million each year in improper payments. Mandatory funding authorized by ARPA for data mining and other ARPA-related program integrity activities expired at the end of FY2005. The FY2006 agriculture appropriations act (P.L. 109-97) and the FY2007 continuing appropriations resolution (P.L. 110-5) each allowed $3.6 million in discretionary funds for data mining and warehousing activities, within the regular annual appropriation for the Risk Management Agency. However, future funding for this activity remains uncertain. Some would like to see permanent funding for program integrity activities addressed in the farm bill.

Specialty Crop and Livestock Concerns. Some specialty crop growers (mainly fruits, nuts, and vegetables) contend that insurance products for their commodities are not available or are developed more slowly than for the more traditional crops. In part, this is because of the large number of specialty crops that are grown. Furthermore, because specialty crops have unique production and risk characteristics, each of the many types of produce require customized insurance programs. Consequently, some specialty crop growers have expressed interest in the expansion of whole-farm insurance programs, which allow farmers in some regions to insure the revenue of the entire farm rather than on a crop-by-crop basis. Others have proposed the formulation of farm savings accounts as a new risk management tool, which would allow farmers to contribute income to an account in a high-income year, and defer paying taxes on the contribution until it is withdrawn in the future in a low-income year.[4] Similarly, livestock growers have expressed interest in expanding pilot programs and developing new programs to assist them in managing their price risks.

2007 Farm Bill Action

Some policymakers have expressed interest in expanding the crop insurance program in the context of the 2007 farm bill and/or complementing it with a permanent disaster payment program. However, many view the crop insurance program as a potential target for program cost reductions, and propose using these savings to fund new initiatives in various titles of the farm bill.

Administration Proposal. The Administration's farm bill proposal contains several crop insurance recommendations that it claims will enhance participation; address issues of waste, fraud and abuse; reduce costs; and reduce the need for emergency supplemental disaster payments.[5]

One Administration-proposed change to the program would allow participating farmers to purchase insurance for the portion of their production that is part of their deductible, and not currently covered by crop insurance. The Administration is opposed to a permanent disaster payment program, and contends that its proposed deductible or "gap" coverage would help preclude the need for supplemental disaster payments. Under this proposed supplemental deductible coverage plan, a producer could purchase an additional policy, and a payment would be made when losses in the producer's county exceed a certain threshold.

The Administration also recommends several cost-saving measures to the program, including reducing premium subsidies by 2 to 5 percentage points, and charging premiums for the catastrophic level of coverage (which currently is premium-free). The Administration proposal would require the private insurance companies to absorb more of the cost of the program through a proposed 2 percentage point reduction in the A&O expense reimbursement and by requiring the companies to absorb more of the program losses. The Administration also proposes a requirement that farmers purchase crop insurance as a prerequisite for participating

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[4] Such tax-favored saving accounts for farmers have been introduced in past Congresses under such names as Farm And Ranch Risk Management (FARRM) Accounts and Farm, Fish, And Ranch Risk Management (FFARRM) Accounts.

[5] For the Administration's summary of its farm bill proposals addressing the crop insurance program, see *2007 Farm Bill Proposals, United States Department of Agriculture,* pp.149-164.

in the farm commodity support programs.[6] The Congressional Budget Office estimates that all of the Administration's cost-saving proposals would reduce federal outlays by $882 million over five years (FY2008-2012), while the proposed supplemental deductible coverage would increase spending by $148 million over the same period.

House-Passed Farm Bill (H.R. 2419). As passed by the House, H.R. 2419 contains several revisions to the crop insurance program. Virtually all of these changes are cost-saving measures, which CBO preliminarily has estimated at $4.0 billion in reduced federal outlays over five years (FY2008-2012). (See Table 2 for a description of the major cost-saving provisions.)

Nearly $2.7 billion of this estimated savings is attributable to changes in the timing of premium receipts from farmers, and payments to the companies. Neither would directly affect the final monetary amounts for participating farmers or insurers, but would still be scored as savings within the five-year horizon of the bill. However, $1 billion of the five-year savings is realized by requiring insurance companies and farmers to share more in program costs. Farmers would be required to pay higher fees for catastrophic coverage and some plans would provide somewhat lower premium subsidies. Participating insurers would see smaller reimbursements for their operating expenses and would be required to share more of their underwriting gains with the government. The House-passed bill also authorizes $11 million in mandatory funding in FY2008 and $7 million in FY2009 and subsequent years for data mining activities of USDA's Risk Management Agency, in an effort to reduce waste, fraud, and abuse within the program. Based on past experience of agency activities to monitor program abuses, CBO estimates that this funding will generate $125 million in program savings, more than offsetting the cost of the initiative.

The House-passed bill does not include a provision for a permanent disaster payment program. The House Agriculture Committee reported version of the bill would have authorized USDA to implement a permanent disaster payment program, but only if a budgetary offset was made for the additional cost. CBO projected that this permanent program for crops, livestock, and trees, as proposed by Chairman Peterson, would have cost approximately $950 million per year. The House-passed bill also does not contain a committee provision that would have allowed insured farmers to opt for additional coverage on the deductible portion of their policies, which was similar in concept to the Administration-proposed supplemental deductible coverage plan (see "Administration Proposal" above).

[6] Such a requirement was instituted in 1994 crop insurance legislation (P.L. 103-354), but was subsequently rescinded in the 1996 farm bill (P.L. 104-127).

Table 2. Selected Crop Insurance Provisions in the House-Passed Farm Bill (H.R. 2419)

Current Law or Policy	House-Passed Farm Bill (H.R. 2419)
Timing of Payments and Receipts: The federal government provides three levels of subsidy to the crop insurance program, by: 1) subsidizing a portion of the premium paid by farmers, 2) reimbursing the private crop insurance companies for most of their administrative and operating expenses, and 3) absorbing most of the program losses.	Three provisions would change the timing of crop insurance receipts (premium collections) and the timing of payments to the private companies. These changes are timed so that in the final year of the five-year farm bill (FY2012) revenues will be received twice in the fiscal year and reimbursements will be delayed until the next fiscal year. Total budget authority will not be affected, but because of the one-year adjustment in FY2012, CBO scores outlay savings of **$2.7 billion** in FY2012.
Private Insurance Company Subsidies: Participating private crop insurance companies are reimbursed by the federal government for their administrative and operating expenses at rates determined in a Standard Reinsurance Agreement (SRA). Current law prohibits companies from receiving a reimbursement greater than 24.5% of total premiums. However, the current SRA establishes the reimbursement rate below the statutory maximum for all plans of insurance, ranging from 18.1% to a maximum of 24.2%.	Beginning in the 2009 reinsurance year (July 1, 2008), the reimbursement rate to the private crop insurance companies for their administrative and operating expenses would decline by 2.9 percentage points from the rate in effect at the time of enactment of the 2007 farm bill. Hence, the range of reimbursement rates would decline to a range of 15.2% to 21.3%. CBO estimates this provision will reduce outlays by **$612 million** over five years. (Separately, a provision in Title XII (Additional Offsets) would require the maximum statutory reimbursement rate to be adjusted downward in 2012 through 2017, if offsetting oil and gas receipts collected by the Secretary of the Interior fall short of estimates.)
Fees for Free Coverage: Producers opting for the most basic level of crop insurance (catastrophic (CAT) coverage) pay no premium for the coverage, but are required to pay an administrative fee of $100 per crop per county. Producers who grow an uninsurable crop can also receive the equivalent of CAT coverage under a separate Noninsured Assistance Program (NAP) and must also pay a $100 administrative fee.	Increases the producer-paid fee for catastrophic coverage under the crop insurance program and the Noninsured Assistance Program to $200 per crop per county, saving a combined CBO-estimated **$228 million** over five years.

Current Law or Policy	House-Passed Farm Bill (H.R. 2419)
Risk Sharing: The current Standard Reinsurance Agreement between the federal government and the private crop insurance companies determines levels of risk sharing between the government and the companies. The current agreement requires the companies to reinsure 5% of their retained premium with the government.	Requires the private insurance companies to reinsure at least 22% of their retained premiums with the government, and in return the government will provide a ceding commission of 2% to the companies. (The net effect is to raise the requirement to 20%.) This will allow the government to receive some underwriting gains that would otherwise accrue to the companies, which CBO estimates would save **$121 million** over five years.

Senate Finance Committee Permanent Disaster Trust Fund. To date, the Senate Agriculture Committee has not yet marked up its version of the 2007 farm bill. Committee consideration had been delayed until the Senate Finance Committee reported related legislation for various changes to the tax code related to agriculture and other agricultural provisions. On October 4, 2007, the Senate Finance Committee approved legislation that, among its many provisions, would authorize a permanent trust fund to make agricultural disaster payments available on an ongoing basis over the life of the next farm bill. According to CBO, the program would cost $5.1 billion over five years, which is approximately equal to the annual average amount of *ad-hoc* disaster payments that have been provided by Congress over the past 20 years. Most of the cost would be funded through a mandated transfer of 3.34% of annual customs receipts from the U.S. Treasury to the new trust fund.

According to a Senate Finance Committee summary of the legislation, the proposed disaster payment program would supplement the current crop insurance program, and would require a farmer to carry at least the catastrophic level of coverage as a prerequisite for a payment. An eligible farmer in a disaster-declared county would receive 52% of the difference between an established guaranteed level of revenue and actual total farm revenue. The target level of revenue would be based on the level of crop insurance coverage selected by the farmer, thus increasing if a farmer opts for higher levels of coverage.

The Finance Committee proposal also allows the trust fund to be tapped for indemnity payments to livestock producers and orchardists to compensate for significant mortality losses caused by a natural disaster. Up to $35 million annually from the fund also could be used for livestock, honey bee, and farm-raised fish losses caused by adverse weather or other environmental conditions.