Proposals to Reduce Premium Subsidies for Federal Crop Insurance

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Summary

Many farm policymakers generally consider the federal crop insurance program as the principal tool to help farmers cope with the variable impact of weather on crop yields. The program makes available subsidized policies that farmers may purchase each year to protect against yield and/or revenue declines during a particular growing season. Policies are available for about 130 commodities, covering crops supported by traditional farm programs (e.g., corn, wheat, and soybeans) as well as many fruits, vegetables, tree nuts, nursery crops, pastureland, and other commodities. Farmers pay a portion of the premium, unlike farm programs, which are free.

Premium subsidies for federal crop insurance have been instrumental in expanding program participation to levels acceptable to policymakers (i.e., avoiding ad hoc disaster assistance). Congress first introduced premium subsidies in 1980 and increased them in 1994 and 2000. Currently, the subsidy percentage ranges from 38% to 100% of the policy premium. The mix of policies purchased by producers (with varying coverage levels) translates into an average premium subsidy of 62%, resulting in an annual federal cost of $6.5 billion per year. The 2014 farm bill (P.L. 113-79) bolstered the program by authorizing more risk products.

Crop insurance subsidies, by design and like other purchasing-based subsidies, encourage farmers to purchase more insurance than they otherwise would because they are not paying full price. The higher coverage provides better farm financial protection (up to 85% of expected farm yields or revenue) and reduces the probability of requests for federal ad hoc assistance, but it also increases costs to taxpayers and can encourage production on environmentally sensitive land. Some question whether current subsidy levels are necessary to maintain program participation.

Given federal budget pressures, the 114th Congress might consider trimming government costs of the federal crop insurance program pending the outcome of the FY2016 budget. Several proposals have surfaced that would limit premium subsidies, including an Administration proposal and several bills introduced in the 114th Congress. The Administration's FY2016 budget proposal would reduce premium subsidies by 10 percentage points for revenue protection policies with "harvest price coverage." Unlike for other policies, the guarantee is revised upward when the harvest-time price is higher than the initial guarantee established prior to planting. Another proposal (S. 463/H.R. 892) would completely eliminate subsidies on those policies. A separate approach, S. 345, would establish a subsidy cap of $50,000 per person for all policies purchased.

The magnitude of any subsidy reduction would have varying impacts on the income of farmers and crop insurance companies, as well as the overall cost of the farm safety net, particularly if ad hoc assistance is enacted later as an additional backstop for farmers. A relatively small cut would most likely cause farmers to pay more for their existing coverage or to shift to less expensive policies and absorb more risk. It would also likely have minimal impacts on the size of the risk pool and therefore little effect on premiums, which could rise if farmers stop buying insurance. Crop insurance companies could see lower incomes, because their revenue depends on product sales. In contrast, a large cut would most likely result in farmers reducing levels of coverage, perhaps significantly, and overall program participation (acreage) could decline sharply.

Congress will likely continue to weigh the overall benefits of the program to the farm sector with the cost of the federal crop insurance program and other aspects of the farm safety net. The tradeoff for Congress is finding what reductions (if any) to premium subsidies can be tolerated before pressure to make ad hoc payments occurs.

Contents

Figures

Tables

Contacts

Given federal budget pressures and changing government priorities, the 114th Congress might consider trimming government costs of the federal crop insurance program pending the outcome of the FY2016 budget. A potential target is the policy premium subsidy, which reduces the price that farmers pay for federal crop insurance policies. The subsidy percentage ranges from 38% to 100% of the premium, depending on the policy and coverage level selected by the producer. The mix of policies purchased by producers (with varying coverage levels) translates into an average premium subsidy of 62% and an annual federal cost of about $6.5 billion per year.

When contemplating reductions to the statutory subsidy schedule, as proposed by the President's budget and by bills introduced in the 114th Congress, a basic policy tradeoff is that a reduction in the premium subsidy could reduce the amount of insurance purchased by farmers and adversely affect participation in the program. Such an outcome could limit the effectiveness of the federal safety net for farmers and possibly create a larger federal liability for ad hoc crop disaster assistance. A reduction in premium subsidies also reduces incentives for risk-taking (e.g., expanding production on land that would otherwise not be planted). This report examines current premium subsidies, proposals to limit them, and potential options for Congress.

Role of Federal Crop Insurance

The federal crop insurance program began in 1938 when Congress authorized the Federal Crop Insurance Corporation (FCIC). The program, as administered by the U.S. Department of Agriculture's (USDA's) Risk Management Agency and funded by the FCIC, makes available subsidized policies that farmers may purchase each year to protect against yield and/or revenue declines during a particular season. Guarantees are established just prior to planting, based on expected market prices and historical farm yields. This compares with statutory prices used in farm commodity support programs, which provide price and income support for a much narrower list of "covered and loan commodities," such as corn, wheat, rice, and peanuts. Also, participation in price and income support programs is generally free, whereas producers must pay a portion of any crop insurance premium in order to participate.

Insurance policies are sold and completely serviced through 18 approved private insurance companies. The insurance companies' losses are reinsured by USDA, and their administrative and operating costs are reimbursed by the federal government (i.e., not by the producer). In 2014, federal crop insurance policies covered 294 million acres, and total liability was $110 billion. Four crops—corn, cotton, soybeans, and wheat—have accounted for more than 70% of total acres enrolled in crop insurance. Less widely planted crops and pastureland account for the remainder.

Many agricultural producers and farm policymakers generally consider the federal crop insurance program as the principal tool for coping with the variable impact of weather on crop yields and producer cash flows. Policies are available for about 130 commodities, covering crops supported by traditional commodity programs (e.g., corn, wheat, and soybeans) as well as many fruits, vegetables, tree nuts, nursery crops, pastureland, and other commodities. Yields or revenue can be insured at levels between 50% and 85% of expected value, depending on the policy purchased by the producer.

As part of the general policy emphasis in the 2014 farm bill (Agricultural Act of 2014, P.L. 113-79) to provide more risk management tools and amid widespread support among the farm community and the crop insurance industry, Congress increased expenditures on the crop insurance program by expanding commodity coverage and providing supplemental policies to further expand farmers' set of risk management tools. With these changes and additional participation in the program, federal outlays for crop insurance is expected to average $8.8 billion per year during FY2015-FY2024, according to the Congressional Budget Office, making it the

single largest cost component of the farm safety net. To help pay for crop insurance expansion and to accomplish other farm bill goals, including budget savings and greater price protection under farm commodity programs, Congress eliminated "direct" cash payments (saving $5 billion per year), which had been available to farmers and landowners of program crops since 1996.[1]

Level of Support in Question

While political support for federal crop insurance has been generally strong for decades, the absolute level of support has become a policy question. Press reports have noted growing political pressure on reducing premium subsidies for federal crop insurance.[2] In early February 2015, as part of the FY2016 budget proposal to Congress, the Administration recommended that Congress reduce premium subsidies for farmers in order to fund other priorities and offset higher than anticipated costs of farm commodity programs. USDA has also commented that lower subsidies would make it easier to defend the program to non-farmers.[3]

Groups concerned with federal outlays and/or farming on environmental-sensitive land have advocated strongly in recent years for reducing expenditures on federal crop insurance. During the debate prior to enactment of the 2014 farm bill, critics of federal crop insurance led unsuccessful efforts to reduce federal expenditures of the program. Importantly, some critics do not necessarily call for elimination of the crop insurance program. Rather, they prefer crop insurance over the traditional price and income support programs, which use statutorily fixed prices and are considered more market-distorting than crop insurance. Others argue that, while large premium subsidies were necessary to encourage farmer adoption of crop insurance, most producers now recognize the value of crop insurance and would be willing to pay a "fairer" share of the premium.

Many supporters do not want to see premium subsidies or other aspects of the federal crop insurance program altered because of its importance to farmers, input suppliers, and the rural economy in general. Moreover, crop insurance is considered less susceptible than traditional price support programs to challenges under World Trade Organization rules because the guarantee is based on market prices, and participants absorb a loss before receiving an indemnity. Supporters also point out that financial assistance to the farm sector is not unlike benefits Congress bestows on other sectors such as energy (via tax credits) and housing (tax deductions).

Program Costs

The total federal cost of the federal crop insurance program averaged $8.7 billion annually during FY2010-FY2014. The largest portion has been the premium subsidy, which is approximately $6.5 billion annually. Farmers also benefit from free program delivery through the federal reimbursement of private crop insurance companies for their costs of selling and servicing the policies. These "administrative and operating (A&O) expenses" are about $1.4 billion per year.

[1] An overview of the entire farm safety net is provided in CRS Report R43758, *Farm Safety Net Programs: Background and Issues*. Additional background on crop insurance is in CRS Report R40532, *Federal Crop Insurance: Background*.

[2] For example, see Chris Clayton, "Farm Bureau Focused on WOTUS," *DTN Progressive Farmer*, January 11, 2015.

[3] Jerry Hagstrom, "Vilsack: Conaway Has 'No Foregone Conclusions' on SNAP, but Review Unlikely to Affect Crop Insurance," *Hagstrom Report*, January 13, 2015, http://www.hagstromreport.com/2015news_files/2015_0113_vilsack-conaway-no-foregone-conclusion-snap.html.

Another federal cost component is underwriting. Program losses and gains are shared between the federal government and private crop insurance companies, with the government absorbing excess losses in years with poor crop yields. In contrast, overall federal costs are reduced in years when there are underwriting gains for the program (resulting from above-average yields), which occurred in six out of 10 years between 2005 and 2014.

Together, the premium subsidies, A&O expenses, and underwriting losses/gains are considered mandatory spending in the federal budget (i.e., receiving such sums as necessary rather than a fixed appropriation) which varies year to year depending upon producer participation, crop yields, market prices, and other factors. The final cost component is discretionary spending for USDA/RMA's administrative costs, which are about $70 million annually.

Crop Insurance Policies

When purchasing a policy, a farmer selects the type of guarantee, generally one based either on (1) historical farm yields or (2) revenue using historical yields and current-year market prices. Other policy types are also available.[4] The participating farmer specifies the coverage level, which establishes the guarantee as a portion of the expected crop value. Catastrophic policies have a deductible of 50% (the farmer absorbs the first 50% of loss), and the premium is covered completely by the federal government (100% subsidy). More expensive policies with "buy-up" coverage reduce the out-of-pocket loss (deductible) when the insured files a claim. For crop insurance purposes, a deductible of 25%, for example, is referred to as a "75% coverage level." As coverage levels rise, the premium subsidy percentage declines (see "Premium Subsidy Mechanics" below).

For selected crops, farmers may purchase an additional policy called Supplemental Coverage Option (SCO), authorized by the 2014 farm bill and subsidized at 65%, to cover part of the out-of-pocket loss (deductible) on the producer's underlying policy (the "shallow loss"). Indemnities are triggered by county losses greater than 14%, and policy coverage cannot exceed the difference between 86% and the coverage level selected by the producer for the underlying policy.

Besides the premium subsidy (62% of the premium, on average) and the availability of a financial backstop, another major benefit for producers is the timely payment for crop losses, generally about 30 days after the farmer signs the claim form.[5]

Rationale for Premium Subsidies

In the absence of premium subsidies and free delivery, it is generally agreed that farmer participation in the crop insurance program and/or purchased coverage levels would be lower and that paying the full premium would be cost-prohibitive for many farmers. Crop insurance premiums were not explicitly subsidized until Congress enacted the Federal Crop Insurance Act of 1980. The legislation included a 30% premium subsidy and other provisions to increase program participation in an attempt to shift away from costly disaster payments that compensated producers following weather-related losses.[6] Participation in the federal crop insurance program

[4] Whole farm policies, area-wide (county) based policies, and other products are described in CRS Report R40532, *Federal Crop Insurance: Background*.

[5] The 2014 farm bill also authorized a similar policy for upland cotton called Stacked Income Protection Plan (STAX). For more information, see CRS Report R43494, *Crop Insurance Provisions in the 2014 Farm Bill (P.L. 113-79)*.

[6] Randall A. Kramer, "Federal Crop Insurance 1938-1982," *Agricultural History*, vol. 57, no. 2 (May 1983), pp. 181-
(continued...)

grew in the 1980s, but it was not enough to avoid congressional ad hoc disaster assistance later in the decade, including more than $3 billion in direct disaster payments for 1988 crop losses. As a result, to encourage participation of new farmers and expand coverage levels purchased by existing participants, Congress enhanced the program with greater premium subsidies and other changes in two pieces of legislation: the Federal Crop Insurance Reform Act of 1994 (P.L. 103-354) and the Agricultural Risk Protection Act of 2000 (P.L. 106-224).

These and other laws enacted since 1980 have resulted in widespread use of federal crop insurance. Policies now cover nearly 300 million acres, and approximately 83% of U.S. crop acreage is insured. For major crops, a large share of plantings is covered. In 2014, the portion of total corn acreage covered by federal crop insurance was 87%; cotton, 96%; soybeans, 88%; and wheat, 84%. Most policies are "buy-up" at 70% coverage levels or higher (a deductible of 30% or less). A number of fruit and vegetable crops have acreage participation rates that exceed 75%.

While not an explicit goal of the crop insurance program, the premium subsidy transfers money from taxpayers to the farm sector because, over the long term and in the aggregate, indemnities received by producers exceed the value of farmer-paid premiums. For example, a revenue protection policy in McLean County, IL, pays an insured farmer about $9.77 per acre, on average, more than the policy premium cost over the long run.[7] Nevertheless, the subsidy is a not a cash payment. It appears on the producer's bill from the insurance company as a "risk subsidy" provided by FCIC.

Premium Subsidy Mechanics

The premium subsidy for federal crop insurance is set in statute as a percentage of the total premium (7 U.S.C. §1508(e)). The percentage depends on the type of policy, coverage level selected by the producer, and the type of "unit" insured (e.g., individual fields or countywide). See **Table 1**. The premium schedule is "crop neutral," meaning it applies uniformly across all commodities. The only exception is the 80% subsidy for the Stacked Income Protection Plan (STAX), which is available only for upland cotton.

Table 1. Crop Insurance Premium Subsidy Schedule
(government-paid portion of premium as a percent of total premium)

	Coverage Level (%)									
Type of policy	**CAT**	**50**	**55**	**60**	**65**	**70**	**75**	**80**	**85**	**90**
	Premium subsidy (%)									
Policies with basic or optional units	100	67	64	64	59	59	55	48	38	n/a
Policies with enterprise units	n/a	80	80	80	80	80	77	68	53	n/a
Area yield plans	n/a	n/a	n/a	n/a	n/a	59	59	55	55	51
Area revenue plans	n/a	n/a	n/a	n/a	n/a	59	55	55	49	44
Whole farm (one commodity)	n/a	67	64	64	59	59	55	n/a	n/a	n/a

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[7] Bruce Sherrick, "Crop Insurance Decisions for 2015," *farmdocdaily*, March 3, 2015, http://farmdocdaily.illinois.edu/2015/03/crop-insurance-decisions-for-2015.html.

	Coverage Level (%)									
Type of policy	**CAT**	**50**	**55**	**60**	**65**	**70**	**75**	**80**	**85**	**90**
(two commodities)	n/a	80	80	80	80	80	80	n/a	n/a	n/a
(three commodities)	n/a	80	80	80	80	80	80	71	56	n/a
Supplem. Coverage Option (SCO)					65[a]					
Stacked Income Protection Plan (STAX) for upland cotton	n/a	n/a	n/a	n/a	n/a	80	80	80	80	80

Source: 7 U.S.C. §1508(e); and 7 U.S.C. §1508b(d) for STAX.
Notes: n/a = not applicable. Coverage level = 100% minus deductible percentage. A basic unit covers land in one county with the same tenant/landlord. An optional unit is a basic unit divided into smaller units by township section. An enterprise unit covers all land of a single crop in a county for a producer, regardless of tenant/landlord structure. For catastrophic (CAT) policies, a loss beyond 50% is indemnified at 55% of the expected price. For 50% coverage level, a loss beyond that percentage is indemnified at a higher percentage of price (selected by the purchaser) within a minimum and maximum range set by RMA.

a. For SCO, coverage equals 86 percent minus the selected coverage level of the underlying policy.

In general, the subsidy percentage declines as the coverage increases (i.e., the deductible declines). However, the dollar amount of subsidy rises with higher levels of coverage (because the premiums rise with higher coverage levels). The maximum subsidy is 100%, which applies to catastrophic (CAT) policies where the deductible equals 50%. In this case, the producer absorbs the initial loss up to 50% of the guarantee, and the policy covers any additional losses. While the premium is fully subsidized, producers must pay a $300 administrative fee for each crop insured in each county. For "buy-up" coverage (i.e., above CAT), the premium subsidy ranges from 38% to 80% of the policy premium, depending on the coverage level selected by the producer. In recent years, the average subsidy rate across all policies purchased has been 62%. The average subsidy percentage has been at or near 60% since the current subsidy schedule was put in place by the Agricultural Risk Protection Act of 2000.

Higher subsidy levels are available for beginning farmers or ranchers with less than five years of experience. For these farmers, the $300 fee for purchasing CAT coverage is waived, and the premium subsidy for additional coverage is increased by 10 percentage points.

Unlike farm commodity programs, the federal crop insurance program does not have per-person premium subsidy limits or an income limit test for program eligibility, although the topic was widely discussed in Congress during the farm bill debate, particularly in 2012 and 2013. In fact, a controversial item not included in the 2014 farm bill (P.L. 113-79) was the reduction of premium subsidies for high-income farmers, a provision that was included in the Senate bill but not the House bill. Previously, in the 2012 farm bill passed by the Senate in the 112th Congress, an amendment was adopted during floor debate to reduce crop insurance premium subsidies by 15 percentage points for producers with average adjusted gross incomes greater than $750,000.[8] In 2013, the Senate Agriculture Committee–reported version of S. 954 did not include the provision, but an amendment to S. 954 requiring the subsidy reduction was adopted on the Senate floor in June 2013 by a vote of 59-33. A House amendment to limit crop insurance premium subsidies failed during floor debate in June 2013.[9]

[8] The 112th Congress began work on a farm bill but did not complete it, requiring new bills to be introduced in the 113th Congress.

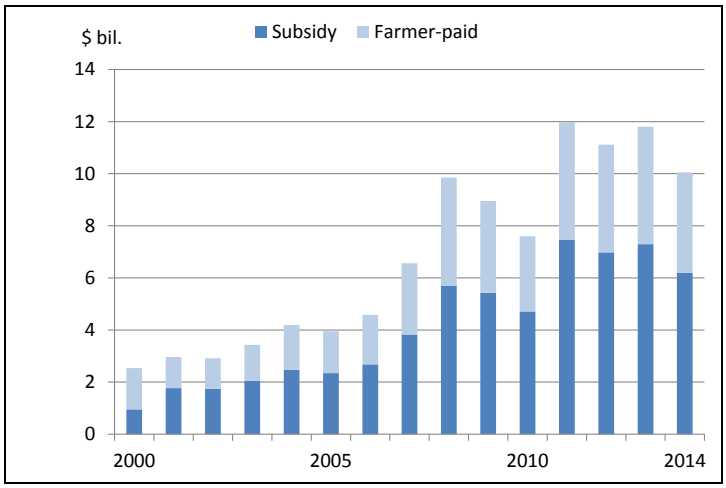
[9] In the House farm bill debate, prior to the floor vote on the farm bill on June 20, 2013 (which was rejected by a vote of 195-234), the House rejected H.Amdt. 216 by a vote of 208-217. It would have limited premium subsidies to those (continued...)

While no limits to subsidies were included in the enacted 2014 farm bill, a few conservation-related restrictions were enacted. Producers are not eligible for premium subsidies if they are not in compliance with conservation requirements for wetlands and/or highly erodible land. Also, crop insurance subsidies are reduced for plantings on native sod acreage in certain states.

Trends in Total Premiums and Premium Subsidies

During the last decade, increases in insured acreage and higher crop prices have increased gross liability, which translated into higher total premiums (**Figure 1**).[10] During the five-year period from 2010-2014, total premiums averaged $10.5 billion, up from $5.0 billion during 2000-2009. For the 2010-2014 period, the farmer-paid share of the total was $4 billion, on average, and the government-paid share (premium subsidy) was $6.5 billion, on average.

Figure 1. Total Premiums—Farmer-Paid Plus Subsidy, 2000-2014



Source: CRS, using data from USDA, Risk Management Agency, http://www.rma.usda.gov/data/sob.html.

Notes: Crop year data. Total premiums advanced beginning 2007 following a significant rise in crop prices, which increased total liability and premiums. A decline in premiums generally reflects lower crop prices.

Crop prices during the next five years are expected to be lower than during the 2010-2014 period, which would reduce total premiums (and crop insurance premium subsidies). According to the Congressional Budget Office, the total premium value during 2015-2019 is projected to average $9 billion per year, with producers paying $3.4 billion, on average, and the government paying $5.6 billion, on average. Of course, any projection of the future is subject to changing market conditions.

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producers with an adjusted gross income under $250,000, limited per-person premium subsidies to $50,000, and capped crop insurance providers' reimbursement of administrative and operating expenses at $900 million and reduced their rate of return to 12%.

[10] Liability represents total exposure of the program, meaning that if all participating farmers suffer losses to the full extent of coverage, indemnities would be the total liability.

Subsidies by Crop and State

Premium subsidies in 2014 totaled $6.2 billion. Reflecting sizeable planted area, four crops—corn, soybeans, wheat, and cotton—accounted for 80% of the total, or $5 billion. Farm states with large acreages of one or more of these crops received the largest amounts of premium subsidies, including Texas ($640 million), North Dakota ($598 million), South Dakota ($491 million), Kansas ($403 million), and Minnesota ($392 million). A summary of top states and crops is displayed in **Table 2**. The top seven states account for just over one-half of the total premium subsidy in 2014.

Table 2. Premium Subsidies in 2014 by Crop and State

(millions of dollars)

State	Corn	Soybeans	Wheat	Cotton	Fruit, veg., tree nut & nursery	Other	Total
1. Texas	52	4	112	329	13	129	640
2. North Dakota	163	147	168	0	11	108	598
3. South Dakota	264	127	56	0	<1	45	491
4. Kansas	103	70	161	1	1	67	403
5. Minnesota	203	134	23	0	7	25	392
6. Iowa	260	120	<1	0	<1	4	384
7. Illinois	243	112	12	0	2	4	373
8. Nebraska	194	79	23	0	2	20	318
9. Missouri	116	102	14	3	1	7	243
10. California	2	0	5	16	191	27	242
11. Indiana	120	75	5	0	1	4	205
12. Wisconsin	106	35	3	0	8	9	161
13. Ohio	78	73	6	0	2	1	160
14. Oklahoma	8	8	82	11	1	17	127
15. Michigan	44	33	7	0	22	11	117
Other states	229	270	240	129	140	341	1,347
Total U.S.	**2,185**	**1,389**	**917**	**489**	**402**	**819**	**6,201**

Source: USDA Risk Management Agency, http://www3.rma.usda.gov/apps/sob/.

Notes: Totals may not add due to rounding.

Subsidies by Farm Size

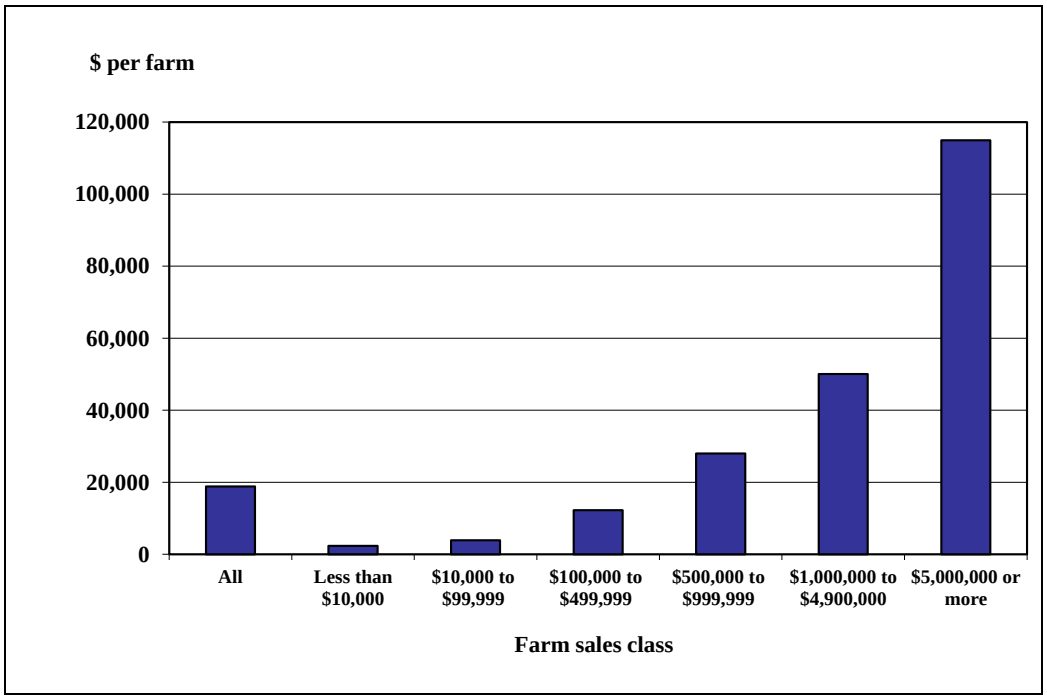
Producer subsidies for crop insurance are proportional to the value of the premiums and underlying liability of the policies. Compared with small farms, larger operations have greater crop liability, which increases the total costs of insurance and value of the government-paid portion of the total premium.

Based on federal crop insurance expenditures data from USDA's Agricultural Resource Management Survey (ARMS) and the average subsidy percentage (62%) from RMA, CRS estimates that the producer subsidy in 2013 averaged about $19,000 per farm for farms

purchasing crop insurance. By farm size, the calculated average ranged from $2,300 per farm for operations with less than $10,000 in sales to $115,000 for farms with at least $5 million in sales (**Figure 2**).

As stated earlier, unlike farm commodity subsidies, crop insurance premium subsidies are not capped and are not subject to a gross income eligibility limit. The next section ("Proposals to Limit Premium Subsidies") reviews proposals that would limit premium subsidies.

Figure 2. Estimated Average Crop Insurance Premium Subsidy per Farm in 2013



Source: CRS Report R40532, *Federal Crop Insurance: Background*, using average premium subsidy of 62% from USDA's Risk Management Agency (RMA) and total federal crop insurance expenditures by farm sales class from USDA's Agricultural Resource Management Survey, provided by USDA's Economic Research Service.

Notes: The calculated average was $18,900 per farm. (Calculation includes only farms that pay federal crop insurance premiums.) Total premium subsidy reported by RMA was $7.3 billion for crop year 2013.

Proposals to Limit Premium Subsidies

Several proposals have been introduced in 2015 to limit premium subsidies. The Administration's FY2016 budget proposal and bills introduced in the 114th Congress would affect the premium subsidy schedule or the total amount of subsidy an individual farm could receive.

Administration's Proposal

To reduce program costs, the Administration's FY2016 budget proposal included two legislative recommendations for the federal crop insurance program. Together they would reduce outlays by

a combined $16 billion over 10 years.[11] Legislation would be required to accomplish either of these recommendations.

The first would reduce premium subsidies by 10 percentage points for revenue protection policies with "harvest price coverage." Unlike for other policies, the guarantee for these policies is revised upward when the harvest-time price is higher than the initial guarantee established prior to planting. This feature is available on policies for crops—such as wheat, corn, and soybeans—that employ a guarantee based on the futures market. Nearly all "revenue protection" policies, representing about three-fourths of all crop insurance policies, are sold with harvest price coverage because the policy can generate a larger indemnity to help cover the cost of purchasing "replacement bushels" at higher market prices if the farmer had previously signed a forward contract and cannot deliver the crop on it due to weather-related losses. The estimated savings of this recommendation is $14.6 billion over 10 years, according to the Administration. The Administration and others argue that such "up-side" price protection does not need to be subsidized by the government. USDA says producers would pay an out-of-pocket premium that more closely matches the market price of the purchased coverage, shifting more of the cost from the taxpayer to the producer. Producers could also switch to less expensive policies and consequently absorb more risk.

The second proposal (Administration-estimated savings of $1.4 billion over 10 years) would change "prevented planting coverage," which indemnifies producers when crops cannot be planted for weather reasons. The changes include adjusted payment rates and lower yield guarantees.

Supporters of the measure include Taxpayers for Common Sense, which commented that the proposals to cut crop insurance could go further.[12] The Environmental Working Group (EWG) said the proposals would cut "overly generous premium subsidies ... save taxpayers billions of dollars" and "shield land and water from further abuse."[13] A previous report issued by EWG concluded that the crop insurance industry would bear most of the cost of farmers switching to less-expensive policies that are less profitable to sell and service.[14]

In early February 2015, leaders of the House and Senate Agriculture Committees heavily criticized the Administration's proposal. House Agriculture Committee Chairman Mike Conaway said the cuts "would jeopardize the ability of producers to insure their crops in a climate of collapsing crop prices, major crop losses, and falling farm income."[15] Senate Agriculture Committee Chairman Pat Roberts said the proposal "ignores the concerns of the nation's farmers and ranchers."[16] Later in February, nearly 400 organizations representing a broad coalition of

[11] USDA, *FY2016 Budget Summary and Annual Performance Plan*, February 2015, http://www.obpa.usda.gov/budsum/fy16budsum.pdf.

[12] Taxpayers for Common Sense, *TCS Analysis of President's FY2016 Budget*, February 2, 2015, http://www.taxpayer.net/library/article/tcs-analysis-of-presidents-fy2016-budget.

[13] Environmental Working Group, *Budget Proposal Would Reform Broken Crop Insurance Program*, February 2, 2015, http://www.ewg.org/release/budget-proposal-would-reform-broken-crop-insurance-program.

[14] Bruce Babcock, *Impact of Scaling Back Crop Insurance Premium Subsidies*, Environmental Working Group, July 11, 2012, http://www.ewg.org/research/impact-scaling-back.

[15] Mike Conaway, "Chairman Conaway Responds to President Obama's FY2016 Budget Proposal," press release, February 2, 2015, http://agriculture.house.gov/press-release/chairman-conaway-responds-president-obama%E2%80%99s-FY2016-budget-proposal.

[16] Senator Pat Roberts, "Senate Ag Committee Chairman Roberts Responds to President's Budget Proposal," press release, February 2, 2015, http://www.ag.senate.gov/newsroom/press/release/senate-ag-committee-chairman-roberts-responds-to-presidents-budget-proposal.

farm conservation, nutrition, rural development, and other interests wrote a letter to congressional leaders of the House and Senate Budget Committees asking them to reject any cuts to programs under the jurisdiction of House and Senate Agriculture Committees, including crop insurance.[17] They argued that the 2014 farm bill has already generated significant savings and that no additional cuts should be made until the new policies have been implemented and thoroughly evaluated.

S. 463/H.R. 892 Eliminates Subsidy for "Harvest Price Coverage"

Rather than reduce subsidies for harvest price coverage, two bills (S. 463 and H.R. 892) would completely eliminate subsidies on those policies. The Congressional Budget Office estimates a reduction in outlays of $16.8 billion over 10 years. Sponsors are Senators Jeff Flake and Jeanne Shaheen and Representative John J. Duncan Jr.

Supporters expect that producers would remain covered by crop insurance but would shift to less-expensive policies, such as Revenue Protection with Harvest Price Exclusion (HPE), which has a price guarantee that does not rise if the harvest-time price is above the initial guarantee set prior to planting. Some producers already purchase this product because of its lower cost. Other interested producers might be those who do not typically hedge much grain prior to harvest or are willing to accept "drought risk" that can drive up overall crop prices.[18] Critics say that not providing this option to producers makes crop marketing more risky because they would no longer have a low-cost way to comfortably sell crops in advance (forward contract). Purchasing options on futures contracts is an alternative, but it is generally more expensive than using the insurance product and may not be viable for producers with small acreages.

S. 345 Caps Premium Subsidies

Rather than altering the premium subsidy schedule as in the proposals above, S. 345 establishes a subsidy cap of $50,000 per person or entity for all policies purchased. The Congressional Budget Office estimates a savings of $2.2 billion over 10 years. The bill sponsors are Senators Jeanne Shaheen and Pat Toomey.

Supporters argue that the current uncapped program is expensive for taxpayers and results in excessive benefits to individuals and large agribusiness firms. A report by the Government Accountability Office in 2012 found that 53 farmers each received more than $500,000 in premium subsidies.[19] Critics counter that capping premium subsidies would reduce the pool of insured producers, resulting in higher premium rates if large farmers who leave the program were generating underwriting gains.[20]

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[17] Letter from agriculture groups to House and Senate Budget Committees, February 23, 2015, http://farmpolicy.com/wp-content/uploads/2015/02/Letter-Farm-Bill.pdf.

[18] Gary Schnitkey, "Crop Insurance Decisions in 2015," *farmdocdaily*, Unveristy of Illinois, March 10, 2015, http://farmdocdaily.illinois.edu/pdf/fdd100315.pdf.

[19] U.S. Government Accountability Office (GAO), *Savings Would Result from Program Changes and Greater Use of Data Mining*, GAO-12-256, March 2012, p. 20, http://www.gao.gov/assets/590/589305.pdf.

[20] G. A. (Art) Barnaby Jr., "Do Farmers Need Multiple Entities for Crop Insurance Purposes?" Kansas State University Res. and Ext., April 18, 2014, http://www.agmanager.info/crops/insurance/risk_mgt/rm_pdf14/AB_PaymentLimits.pdf. Separately, a GAO report concluded that the highest income participants do not represent a lower risk to the program than participants in the remaining pool; see GAO, *Reducing Subsidies for Highest Income Participants Could Save Federal Dollars with Minimal Effect on the Program*, GAO-15-356, March 2015, p. 18, http://www.gao.gov/assets/670/669062.pdf.

Potential Impacts

All of the legislative proposals described above would save federal dollars. They also raise questions about how farmers would respond to the subsidy reductions. If faced with reduced crop insurance premium subsidies, would farmers (1) maintain coverage levels (and absorb the higher cost), (2) reduce their purchased coverage levels to control farm costs, or (3) abandon the policies altogether? The answer has implications for overall program participation and whether the program remains a viable farm safety net.

Farmers Maintain Coverage

Maintaining coverage would likely prevail if farmers are willing to absorb the additional cost of the policy premium. For example, reducing the subsidy by 10 percentage points would increase the cost of 80% coverage (i.e., deductible of 20%) on a revenue policy for corn in 2014 from approximately $16 per acre to $20 per acre in Illinois and from $29 per acre to $36 per acre in Texas (where weather risk is greater). The additional premium would increase farm operating costs (excluding land costs) by about 2%, depending on the cost structure of the farm. The farmer would need to either find ways to reduce other farm costs or accept a lower return for farming. In years with low prices and projected losses, paying more for the same coverage may not be a feasible option. Nevertheless, if farmers generally maintain existing coverage levels, program participation would remain mostly unchanged, and the farm safety net would remain intact. The impact would be primarily on farm sector income, which would decline.

Farmers Insure Fewer Acres or Reduce Coverage

Reducing purchased coverage levels would be a logical outcome for farmers if subsidies were reduced and they had to pay more for their crop insurance. For a given crop year, if a farmer allocates a maximum of per-acre amount for crop insurance expenses, the producer would need to increase the policy deductible (i.e., personally absorb more risk) in order to avoid the higher cost of crop insurance. This would mean little or no change in program participation, but the farmers would absorb more risk. Research by USDA's Economic Research Service has concluded that as farmers rely more heavily on crop insurance, small changes in premium subsidies will likely not have a major impact on producer demand for crop insurance coverage.[21]

Similarly, if subsidies were capped, large farmers might need to abandon significant amounts of "buy-up" coverage to fit under the subsidy limit, thereby exposing their operations to more risk. When farmers reduce their coverage significantly and crop losses are large, producers would need to brace for a significant reduction in farm income that would have been otherwise buffered by higher indemnities delivered to the insured farmers. In a high-loss year, government costs would be lower (because federal exposure would be less), but Congress could come under pressure to provide additional assistance. Separately, insurance companies approved for selling federal crop insurance could also see a decline in income because their reimbursement from USDA is calculated using total premium amounts, which would decline if producers purchase less coverage.

[21] Erik J. O'Donoghue, *The Effects of Premium Subsidies on Demand for Crop Insurance*, USDA, Economic Research Service, July 2014, http://www.ers.usda.gov/media/1503220/err169.pdf. Additional information on premium subsidies is available in GAO, *Considerations in Reducing Federal Premium Subsidies*, GAO-14-700, September 8, 2014, http://www.gao.gov/assets/670/665267.pdf.

Some Farmers Stop Buying Federal Crop Insurance

If subsidies are reduced, a third option for farmers would be to stop buying federal crop insurance and find some other way to manage risk (or do without). This would occur only if they intentionally choose to expose their operations to significant risks or pursue a less costly form of risk management, such as self-insuring through business diversification or increasing income from off-farm employment. Prior to widespread adoption of crop insurance, the self-insuring option was popular because farmers could generally count on Congress to enact disaster assistance following significant crop losses. This outcome, while still possible, is less likely given the current budget climate.

Many bankers require crop insurance if farmers want to borrow money for input costs. Therefore, a more plausible reaction would be for producers to cut back on coverage levels (see above) rather than holding coverage constant and absorbing its higher cost or completely eliminate federal crop insurance purchases. Nevertheless, if some farmers stop buying crop insurance altogether, some of the risk currently shouldered by the taxpayer would shift to the farm sector. There would likely be declines in crop-insurance-company income and federal program costs (excluding any potential ad hoc assistance). Importantly, if low-risk farmers drop out of the program, their departure would adversely affect the overall insurance pool and potentially raise insurance rates for remaining participants. In general, the larger the pool, the better for keeping the premium rates as low as possible for all producers.

As these three potential outcomes illustrate, the tradeoff for Congress is finding what reductions (if any) to premium subsidies can be tolerated before the crop insurance program is adversely affected and pressure to make ad hoc payments occurs.

Additional Options for Congress

To address the uncertainty over the unknown producer response to changes in premium subsidies and help find the balance between subsidy rates, crop insurance participation rates, and maintaining a large insured pool, Congress could tie any changes to the premium schedule (or imposition of subsidy caps) to program participation. For example, a subsidy reduction could be reversed in whole or in part if acreage participation, coverage levels, or other indicators decline below predetermined levels designated by policymakers. Also, a phase-in period of several years might ease the transition for producers and provide for a monitoring period if policymakers are concerned about any adverse impacts on the farm safety net. A gradual decline toward a predetermined level would allow producers more time to adjust to the higher premium costs and make changes to their coverage levels.

A transitional approach might allay concerns that no one has a firm grasp on how premium subsidy changes affect producer participation, which could lead to ad hoc assistance that might cost taxpayers more in the long run. Opponents would likely voice concerns that the program currently works well, and lower crop prices and challenging farm financial conditions in 2015 make it imperative to keep intact the current subsidy schedule.

An alternative to an absolute subsidy limit (e.g., S. 345 with a subsidy cap of $50,000 per person) would be to employ a subsidy percentage reduction for high-income farmers (as included in the 2013 Senate farm bill). In this case, farmers would receive a graduated level of subsidy based on documented gross sales, income, or some other measure. Beginning farmers already receive a subsidy enhancement, and this approach could be used to adjust the premium subsidy schedule in the opposite direction (downward) for other selected groups (e.g., higher income or higher sales).

Legislators concerned with benefits accruing to large farms would likely support an income limit. Critics of this approach would point to the possibility that the insured pool would decline, leading to higher premiums for all insured producers. Also, some might note that government cost savings are usually not as large for subsidy caps (at levels typically discussed) than for across-the-board reductions to the subsidy schedule because fewer (although large) farms and only a portion of total U.S. acreage would be affected by the limits.

Conclusion

In the last two decades, premium subsidies for federal crop insurance have been instrumental in driving up program participation to levels acceptable to policymakers essentially to the point that prevents the need for ad hoc disaster assistance. Crop insurance subsidies, by design and like other consumer subsidies, encourage farmers to purchase more insurance and/or to expand onto marginal land that otherwise would not be cultivated because they are not paying full price. The higher coverage provides better farm financial protection (up to 85% of expected farm yields or revenue) and reduces the probability of requests for federal ad hoc assistance, but it also increases costs to taxpayers. The question now is what rate of subsidies are needed to maintain program participation at a level acceptable to policymakers, who must balance concerns for farm risk as well as taxpayer costs.

Federal crop insurance is considered by many as the key component of the farm safety net. Congress bolstered it in the 2014 farm bill to provide additional protection for the farm sector, and supporters successfully defended it against attacks by critics who tried to trim premium subsidies. In the 114th Congress, some Members have again introduced legislation to reduce subsidies to save federal dollars and/or reduce benefits to high-income farmers.

The magnitude of any subsidy reduction would have varying impacts on the income of farmers and crop insurance companies, as well as the overall cost of the farm safety net, particularly if ad hoc assistance is enacted later as an additional backstop for farmers. A relatively small cut would most likely cause farmers to pay more for their existing coverage or shift to less-expensive policies or reduce planted area to less marginal land and absorb more risk. It would also have minimal impacts on the size of the risk pool and therefore little effect on premiums, but crop insurance companies could see lower incomes. In contrast, a large cut would result in farmers reducing levels of coverage, perhaps significantly, and overall program participation (acreage) could decline sharply. Congress will likely continue to weigh the overall benefits of the program to the farm sector, especially given the large decline in farm income expected in 2015, with the cost of the federal crop insurance program and other aspects of the farm safety net.

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