The Essential Strengths of Crop Insurance*

The Food, Conservation, and Energy Act of 2008 (2008 Farm Bill), which authorizes the major agricultural programs administered by USDA, expires in the fall of 2012. The process of developing a new farm bill began with Congressional hearings during the summer of 2010. While the process is just starting, many stakeholders have already emphasized the crucial need in the new farm bill for a strong crop insurance program to protect farm income and sustain farms. Even so, some have called for crop insurance program changes, including expansions of other safety net programs into areas now covered by crop insurance. (For example, see the *TODAY* article in this issue on individual and area insurance, page 9.)

As commodity and farm organizations, the Administration and Congress assess policy options, the important benefits provided by the crop insurance program should be recognized, carefully considered, and supported. Farmers and ranchers want and buy crop insurance to protect their livelihoods. Crop insurance is the foremost risk management tool that provides a safety net under their farm income. If a natural disaster occurs or market prices plunge, crop insurance allows the producer to pay bills and remain in operation. Beyond this fundamental strength, there are many other benefits of crop insurance to producers, government and the public. This article describes a dozen essential program features that should make crop insurance the focus of the next farm bill's risk management programs.

1) **Producers Share in the Program Cost.** When a producer wants crop insurance coverage, the producer must pay for it. While the program is partially subsidized by the government, producers have substantial "skin in the game." Their financial contribution helps defray taxpayer costs and encourages financial discipline by producers. This feature is important in making crop insurance more defensible in the eyes of the public and more sustainable over time than other some other safety net programs that are fully subsidized by taxpayers.

2) **Producers Must Take Active Personal Responsibility for Risk Management Choices.** While farm programs help reduce farm financial risks and require producers to protect the land, producers have little to no role in designing a program shaped to their individual farm. Moreover, when participating in crop insurance, the producer must assess the farm's risks and design a crop insurance program that mitigates those risks and is affordable. The producer must learn to manage risk through the conscious selection among many plans of insurance, insurable units (i.e., the area to be insured), coverage levels and premium rates. In addition, the producer must meet the standards of "good farming practices" required by the policy to be eligible for payment when incurring losses. Good farming practices are those required for the crop to produce at least the yield used to determine the insurance guarantee. For example, good farming practices include keeping informed about disease or pest outbreaks, knowing what practices to use (such as those recommended by local extension agents or certified crop consultants) should an outbreak reach the producer's farm, scouting fields and documenting findings, and keeping records of good farming practices on each insurable unit. Thus, crop insurance compels producers to become active risk managers and to operate proficiently.

3) **Producers Receive Individualized Risk Management Solutions.** Crop insurance covers the expected yield or revenue risk of each individual producer. The producer can select alternative coverage levels for the producer's historical yield on the acres planted on a choice of insurable units. Additional rules cover new lands brought into production and production on risky lands. The producer may also receive protection for prevented planting, replanting costs and quality losses. While there are plans of insurance available for purchase that pay out based on county yield and revenue shortfalls (Group Risk Plan (GRP) and Group Risk Income Protection (GRIP)), these plans only accounted for less than four percent of total program premium in 2010. Most producers need and want individual risk protection matched to the



risks and characteristics of their operations, and crop insurance provides it. Other safety net programs are generally structured to be similar across crops and producers for ease of delivery and wide application, and their payments may not fully reflect the individual losses borne by the producer.

4) **Producers Receive Crop Insurance Indemnities in the Timeliest Way.** While some farm programs may make payments fairly promptly, such as marketing loan benefits, others pay out long after the payments are needed. For example, the final countercyclical and Average Crop Revenue Election Program (ACRE) payments for the 2010 spring planted crops will be made no earlier than October 2011. Similarly, the Supplemental Revenue Assistance Payments Program (SURE) payments may occur about 11/2 years after harvest. On the other hand, crop insurance indemnities are paid out close to when the loss occurs. Crop insurance policies require the companies to pay within 30 days of claim settlement. Losses due to disasters like floods or hurricanes and prevented planting and replant payments may be paid well before harvest. Other payments are usually made shortly after harvest. As this article was being written in mid- December, already $2.9 billion is indemnities had been paid for 2010 crop-year losses

5) **Producers Do Not Receive Unnecessarily Excessive Payments.** Crop insurance only pays a producer when, after a fitting production effort, there is a loss due to low price or low production due to natural disaster or both. A trained crop loss adjuster must work the producer's claim. Indemnities received are based on actual losses incurred. Thus, crop insurance rewards proper effort and appropriately protects against events beyond the producer's control. Moreover, crop insurance companies currently employ over 4,700 certified crop loss adjusters who are well trained to accurately assess production losses. This loss adjustment system, which includes adequate training, strict conflict of interest standards, and frequent claim reviews by third parties, has dramatically reduced waste, fraud and abuse in the program.

6) **Producers Can Use Crop Insurance as Collateral for Loans.** When bankers loan to a producer, they require an expectation that the loan can be repaid. Many producers use land, equipment or crops as collateral to secure the loan. Farm program payments can also be part of the collateral. However, some farm program payments may be quite uncertain, and they may not be well correlated with yield or revenue shortfalls of borrowers. Bankers prefer individual crop insurance to area insurance or payments from some of the other farm programs. Subject to the provisions of the policy, individual crop insurance guarantees the financial performance of the business and can be counted on by the banker should production or prices go amiss for the borrower.

7) **Producers Can Use Crop Insurance to Improve their Pre-Harvest Marketing Plans.** Many producers do not take advantage of price increases prior to harvest by using forward sales. They fear that they might not have sufficient production to deliver against a forward contract or enough income to close out a futures or options position. Should disaster strike yields or prices, crop insurance revenue products can provide the income needed to settle forward contracts or futures and options positions. Crop insurance products provide the financial backstop needed to optimize farm marketing.

8) **Producer Indemnities are not Capped by Arbitrary Payment Limits.** All farm programs have limits on a producer's annual adjusted gross farm and off-farm income to be eligible for payments. Farm programs also have annual payment limits for all programs except marketing loans. Direct payments are limited to $40,000 per person (20 percent less if in ACRE); countercyclical payments are limited to $65,000; ACRE payments are limited to $65,000 plus the amount that direct payments are reduced (20 percent); and SURE payments are limited to $100,000. There are no income caps to be eligible to buy crop insurance, and crop insurance premium subsidies and indemnities are not limited.

9) **Producers Benefit from the Efficiencies and Service of the Private Sector Delivery System.** Crop insurance policies are sold and serviced by 15 private sector insurance companies, some 15,000 agents and over 4,700 certified loss adjusters.

Agents and adjusters are generally licensed by state regulators and have annual training requirements imposed by states and USDA's Risk Management Agency (RMA). Market incentives and competition have resulted in intense efforts by crop insurers to meet their customers' needs in the most efficient and helpful ways. Companies have invested heavily in information technology and created an outstanding delivery infrastructure for crop insurance. Evidence indicates producers place a very high value on the timely, customer-centric services of private-sector delivered crop insurance.

10) **Crop Insurance is Comprehensive and Program Features can be Adjusted Quickly.** Crop insurance now covers a broad range of commodities, including farm program crops, horticultural crops, pasture and range and livestock. Importantly, crop insurance products can be quickly adjusted to the changing needs of producers without going through a long legislative process. New crop programs can be developed and put in place and existing programs can be altered by RMA and the Federal Crop Insurance Corporation (FCIC) without Congressional action. Having the flexibility to make major program adjustments also imposes financial discipline on the government, because it has the responsibility and authority to correct or eliminate programs and features that are not working. In a sense, this regulatory flexibility and responsibility makes the program self-correcting. Similarly, the government can update premium rates to reflect changes in program losses and ensure financial integrity of the program without the need for Congressional action.

11) **Crop Insurance Has Already Contributed to Deficit Reduction.** While the budget for the new farm bill remains uncertain, it is likely to be quite limited. The crop insurance program has the benefit of having recently undergone substantial budget cuts, most of which have been earmarked for deficit reduction. The new Standard Reinsurance Agreement (SRA) between the government and the approved insurance companies put into effect on July 1, 2010, reduced crop insurance program spending by a projected $6 billion during 2011-2020, with at least $4 billion of that savings counting toward deficit reduction.

12) **Crop Insurance Has Flexibility to Help Meet WTO Disciplines.** Farm program direct payments are considered not to distort production and trade; thus they are "green box" and not subject to discipline under the WTO. However, marketing loan benefits and ACRE payments are considered production and trade distorting, or "amber box," and subject to discipline. Each dollar spent supporting farmers under these amber box farm programs counts against the limit on support allowed by the WTO. Crop insurance, too, is currently considered amber box, but with some advantages over most other safety net programs. First, crop insurance is considered amber box nonproduct specific (as are countercyclical payments). This means the support that crop insurance provides is grouped with other support that is not tied to a specific commodity, and the total support of these programs does not count against the allowable U.S. support unless the total nonproduct specific support exceeds a cap, or "de minimis" level, equal to five percent of total U.S. farm production value. Second, not all crop insurance subsidies are considered to be crop insurance support. Only net indemnities-gross indemnities minus farmer-paid premiums-are reported as amber box support for crop insurance. Third, crop insurance is generally viewed favorably by the WTO. In fact, crop insurance can be green box, provided several criteria are met, including a formal disaster declaration, indemnities that only cover a loss of 30 percent or greater and do not exceed 70 percent of expected production, and the use of an expected yield that is a three-year average or five-year Olympic average. None of these criteria currently apply to the U.S. crop insurance program, which accounts for its amber box classification. But looking to the future, changes in the crop insurance program and the way it is reported to the WTO, along with provisions under discussion in a new WTO agreement, could result in reduced crop insurance support being reported to the WTO, compared with the current practice, thus easing compliance with WTO limitations.

As farm organizations and government officials formulate their recommended programs for the upcoming farm bill, they should place a heavy weight on the many strengths that crop insurance provides to agriculture. As the above discussion points out, *crop insurance benefits go well beyond indemnities.* The public-private crop insurance partnership, built around individual yield and revenue protection, possesses the strengths to be a sustainable, publicly supported, long-run farm support program. The new farm bill provides an opportunity to maintain and strengthen the program to secure its place as the centerpiece of risk management options for U.S. producers.

** The NCIS Program Development Committee (PDC) is monitoring the progress of the next farm bill and reporting to the NCIS Board of Directors on farm bill issues of interest to the crop insurance industry. PDC members engaged in this activity, including the development of this article, include Ron Brichler (Mark Allison), Great American Insurance Co.; Dan Bird, Rural Community Insurance Services; Gene Grimsley, Agro National Inc.; Bob Haney, Rain and Hail L.L.C.; Kendall Jones, ProAg; Greg Meek, Farmers Mutual Hail Insurance Company of Iowa; Jay Rushing, ARMtech Insurance Services; Wade Shuler, Heartland Crop Insurance, Inc.; and, Tim Weber, Great American Insurance Co. NCIS staff members participating in the development of the document include Laurence Crane, Dave Hall, Tom Zacharias, Frank Schnapp, Mike Sieben, Therese Stom, Loretta Sobba, Troy Brady, Laurie Langstraat, and Harun Bulut, as well as Keith Collins, adviser to NCIS.*