Implications of Crop Insurance as Social Policy

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Summary of talk

• 2014 farm bill irrevocably completed the evolution of crop insurance from an insurance program into a social policy delivery tool
  • New responsibilities
  • Additional scrutiny

• Objective: Highlight some vulnerabilities of the program now that it is the primary farm bill safety net program
Conflict of Interest Disclosure

- I buy crop insurance for my corn and soybeans
- I earn money by developing new crop insurance products
  - Revenue Assurance, Group Risk Income Protection, Livestock Gross Margin, COMBO product premium calculation methods, other new products
- I occasionally explain crop insurance in white papers that are commissioned

Commercial Insurance or Social Policy?

- Commercial Insurance
  - Competition between companies in premium rates and products
  - Regulated by states to protect buyers
  - Premiums sufficient to cover losses, underwriting costs, profit for selling company
  - Customers choose to pay the sufficient premium
  - Losses to the few paid by premiums from the many
Examples

• Business interruption
• Life
• Homeowners
• Medical malpractice
• Automobile

Attributes of Crop Insurance

• No competition in premium rates for MPCI products
  • Competition was in developing add-on products

• Nominally regulated by states but no revenue to states

• Large taxpayer subsidies
Attributes of Crop Insurance

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  - Competition was in developing add-on products
- Nominally regulated by states but no revenue to states
- Large proportion of program cost paid by taxpayers
- Demand for crop insurance driven more by subsidies than the net benefit of insurance
Attributes of Crop Insurance

- No competition in premium rates for MPCI products
  - Competition was in developing add-on products
- Nominally regulated by states but no revenue to states
- Large proportion of program cost paid by taxpayers
- Demand for crop insurance largely driven by pursuit of subsidies than the net benefit of insurance
- Yield risk and price risk are not poolable
**Distribution of Aggregate Loss Ratio for RP**

Source: Simulated by Xiaohong Zhu

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**Crop Insurance Risk is Not Poolable**

Source: Simulated by Xiaohong Zhu
Crop Insurance is Not Commercial Insurance

- No competition
- Federally regulated
- Large taxpayer subsidies
- Lack of demand without subsidies
- Risk is not privately insurable

Crop Insurance as a Farm Program

- Crop insurance title first appeared in 2008 farm bill
- 2014: Risk management rationale front and center
  - Frank Lucas: “Farm safety net creates critical food safety net”
New responsibilities and interventions

- Protection for native sod
- Enforcement of conservation compliance
- Extra premium subsidies and guarantees for “beginning farmers”
- Allow separate enterprise units for irrigated and non-irrigated acres
- Greater boost to yield guarantees when county yields are low
- Allow different coverage levels for different practices

What does Colbert say about crop insurance?
# Obamacare for Corn?

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<th>Affordable Care Act</th>
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<th>Comparable?</th>
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<td>I</td>
<td>Reduce use of expensive emergency room care by expanding number of insured</td>
<td>Reduce use of ad hoc disaster programs by expanding number of insured</td>
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<td>II</td>
<td>Make health insurance more affordable for poorer people</td>
<td>Make crop insurance more affordable for all farmers</td>
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<td>Combat adverse selection by mandating insurance coverage</td>
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<td>Lower cost of health care by increasing competition on insurance exchanges</td>
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<td>Political Reality I</td>
<td>Deliver health insurance through private companies</td>
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<td>Opposition driven mainly by political party</td>
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## More social purpose = greater scrutiny

- Who receives taxpayer support?
- What obligations do recipients have in exchange for support?
- Are social objectives being met cost effectively?
Questions that will be raised under increased scrutiny

• Equity: Is it fair that most subsidies go to largest farms?
• Why do farmers receive more subsidies when times are good?
• How can there be a “loss” when prices fall from record high levels to almost record high levels?
• Why should farmers receive higher indemnities when prices unexpectedly rise?
• Why should farmers receive double payment for a price decline?
• Why is the US government paying private companies to take on risk?
• Why should taxpayers pay for two insurance delivery systems?

What's Been Happening to Farm Size?

What's Been Happening to Farm Size?


Mid-point harvested acres

Average Farm Size

Equity: Corn Example in 2013

• Farmers received $2.83 billion in premium subsidies in 2013 ($33/acre)
• Net indemnities = $3.98 billion ($47 per acre)
• Average payment to 95% of corn farmers:
  • $6600 in premium subsidies; $9,400 in net indemnities
• (Approximate) Average payment to 5% of corn farmers:
  • $82,500 in premium subsidies; $117,500 in net indemnities
• More than half of all corn subsidies went to just 5% of corn farmers
Obvious point

- Larger farms have always received the bulk of farm payments

- Now that crop insurance is a farm program, it will be treated more like a farm program
  - Stronger payment limits passed both House and the Senate in 2013

❖ Payment limits only an issue because of subsidies!

Does Crop Insurance Provide “Good” Farm Support?

- Guarantees based on current-year expected market prices

- What if farmers are making record profits at current prices?

- What if farmers cannot make money at current prices?
Why Does a Price Drop Always Imply a “Loss?”

- Because that is what it says in the insurance contract!
- Corn harvest price in 2008 was $4.43 per bushel
- Harvest price in 2007 was $3.58
- Prices went up by 24% year over year!
- But insured corn farmers were judged to have suffered an 18% loss due to a price drop.
Replacement cost (RP) coverage

• Champaign County, IL 2012 drought year
  • 200 bu APH, Projected price = $5.68
  • Harvested yield = 100, harvest price = $7.50

• 80% RP Guarantee = .8* $1,136/acre = $909/acre

• “Loss” = 909 – 750 = $159/acre

• But Indemnity = $450/acre due to replacement cost coverage

Questions that will be asked:

• How many farmers would buy replacement cost coverage if the extra premium were not subsidized?

• What value do taxpayers or society get from farmers buying replacement cost coverage?

• This feature increases taxpayer costs by about 30% ($27 billion) over 10 years
Why No Integration with PLC?

- PLC price guarantees
  - Corn $3.70/bu
  - Soybeans $8.40/bu
  - Wheat $5.50/bu
  - Barley $4.95/bu
  - Grain sorghum $3.95/bu
  - Rice $14.00/cwt
  - Peanuts $535/ton

Vulnerability

- If crop prices drop below PLC guarantees and below projected prices, insured some farmers will receive double compensation

- LGM for Dairy precedent
Reinsurance Vulnerability

• The Great Recession demonstrated once again that the U.S. government has the deepest pockets of any entity in the world
  
  • Bailed out banks to keep payrolls and lending going
  • Took over GM to keep auto sector viable
  • Deficit increased to more than $1 trillion from 2009 - 2012
  • Fed purchased $4 trillion of assets to inject money into economy

Net Underwriting Gains Paid to Industry

$10 billion
Key Question

- What value have taxpayers obtained by giving crop insurance companies all the underwriting gains ($10 billion) in the last 10 years?

FSA or RMA?

- 2014 farm bill has blurred the lines between Title I farm bill programs and Title 12 crop insurance programs
  - ARC vs SCO
  - Dairy Margin Protection Program vs LGM for Dairy

- RMA busy training FSA personnel to deliver crop insurance (ARC)
Delivery issues

• Without Congressional intervention, crop insurance would be delivered at much lower cost using new technologies combined with competitive pressure.

• Current cost of delivery being held down some due to new RMA regulations.

• FSA delivery of ARC demonstrates that there is an alternative to current delivery system.
What a taxpayer advocate asks:

• Cost of delivering a crop insurance policy has more than doubled since 2000.

• If health insurance can be delivered on-line, why can’t crop insurance?

Summary

• Crop insurance riding high after 2014 farm bill
  • New products
  • Restrictions on saving money from renegotiating SRA
  • Attempts to save significant money defeated

• Cost of victory possibly significant
  • Moves industry further away from commercial insurance
  • Increasingly viewed as a delivery system for social policy
  • More social responsibilities
  • Much more scrutiny from taxpayer advocates