

STATEMENT BEFORE THE U.S. HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

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Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before you to address issues of waste and inefficiency in the crop insurance program. I will focus on three problem areas: (1) the relationship between crop insurance and disaster payment programs, (2) the benefits farmers get from crop insurance subsidies as compared to the costs of the subsidies for the taxpayers, and (3) the effects of subsidized crop insurance on land use and resulting economic and environmental costs.

Crop Insurance and Disaster Payments

Risk of crop failure is one of the most important problems all producers face. The way individuals and small businesses deal with many risks is through the purchase of insurance policies. Insurance companies indeed have made attempts to sell crop insurance for over a hundred years, but this market has never flourished except when heavily subsidized. One reason is that, while farmers are averse to risk, they are not willing to pay as much for risk protection as that insurance tends to cost. However, a private insurance market does exist with willing buyers and sellers for some hazards farmers face—for example, fire insurance. It appears the main reason insurance against crop failure is more difficult to market successfully is adverse selection – some farms are more subject to crop failure than others, in ways that the farmer is aware of but the insurance company is not. Thus insurance companies find themselves insuring only farms with high risks, which are unprofitable to insure without charging premiums so high as to shrink the market unsustainably.

Given the lack of coverage by commercial insurers, Congress in the 1920s began efforts to create a federal crop insurance program, and starting in 1938 a series of pilot and experimental crop insurance programs was initiated. But like private crop insurance, federal crop insurance policies were purchased by too few farmers if those policies charged premiums that covered the indemnity payments that had to be paid out in years of crop failure. Even substantial subsidies did not result in high rates of participation by farmers except when farmers could foresee crop failure on the horizon. A 1942 study reported that “In counties and years when soil moisture was lacking (in the spring), insurance sold freely. In those same counties the number of contracts dropped as much as 75 percent when soil-moisture conditions presaged a good crop.”¹

During 1939-41 the overall loss ratio in federal crop insurance averaged 1.54, meaning the government paid out \$1.54 cents in indemnities for every \$1 of farmers’ premium payments, including federal subsidy. Forty years later, after a serious attempt in the

¹ J. C. Clendenin, “Federal Crop Insurance in Operation,” *Wheat Studies of the Food Research Institute*, Vol. 18, 1942, pp. 229-290.

Federal Crop Insurance Act of 1980 to improve the program, participation did increase, but during 1980-88 the loss ratio still averaged 1.50.²

A response to the shortcomings of federal crop insurance was the Disaster Payments Program, introduced in the 1973 farm bill. Unlike area-based disaster programs which make eligibility for assistance contingent on being in a region of widespread crop failure, the Disaster Payments Program made payments to individual producers of program crops who experienced crop losses, wherever they were located. This program was essentially crop insurance with no premiums charged, and as such was popular with producers. The program was available even in counties where production was so risky that their farms had been declared ineligible for federal crop insurance. The program's payments totaled \$3.4 billion during 1974-80. It was criticized for encouraging farmers to plant on marginal acreage and for reducing farmers' incentives to take preventive measures against crop loss.³ In light of these problems, and in hopes that the Federal Crop Insurance Act of 1980 would lead the way to a more efficient approach, the Disaster Payments Program was not re-authorized in the 1981 farm bill.

What we have experienced in the last 25 years, even after further attempt to improve crop insurance in the Crop Insurance Reform Act of 1994 and the Agricultural Risk Protection Act of 2000, is Congress responding to weather-related disasters with special *ad hoc* programs precisely because so many producers were not adequately covered by crop insurance. Then, in hopes of forestalling future *ad hoc* disaster programs, crop insurance subsidies were increased in order to get more farmers to participate in that program. The thought was that these two approaches – *ad hoc* disaster programs and subsidized crop insurance – were substitutes, and that an appropriate establishment of the latter would preclude the need for the former. So far this hope has not been realized. Table 1 shows the relevant data on federal funding for both crop insurance and disaster payments. What is striking is that after the boosts in spending on crop insurance subsidies in the mid-1990s and again after 2000, spending on *ad hoc* agricultural disaster programs did not decline but rather increased further. In 2003-2006, spending on both together averaged \$4.9 billion, about 4 times the levels of 1980s. Was this just because nationwide crop failures were worse? No. Indeed, U.S. crop yields were above the trend level in this period. More likely it is a matter of not being able to convince some farmers to buy even highly subsidized insurance when experience has revealed that a serious disaster will be followed by an *ad hoc* relief program.

Benefits and Costs of Crop Insurance

Crop insurance subsidies generate benefits for the producers who receive indemnity payments. In fiscal years 2003-2005, an average of \$3.0 billion in indemnities was paid

² These data are from records of the Federal Crop Insurance Corporation. See, B. Gardner, "Crop Insurance in U.S. Farm Policy," in D. Hueth and H. Furtan, eds., *Economics of Agricultural Crop Insurance*, Boston: Kluwer Academic Publishers, 1994, pp. 17-44.

³ See U.S. General Accounting Office, "Alleviating Agricultural Producers' Crop Losses," 1976, and T.S. Miller and A.S. Walter, "An Assessment of Government Programs that Protect Agricultural Producers from Natural Risks," *Agricultural-Food Policy Review*, 1977, pp. 93-103.

Table 1. Federal Expenditures on Crop Insurance and Disaster Assistance Programs.

Fiscal Year	Millions of Dollars		Sum
	Crop Insurance	Disaster Payments	
1981	249	1,030	1,279
1982	160	306	466
1983	334	115	449
1984	487	1	488
1985	521	0	521
1986	504	0	504
1987	309	1	310
1988	945	37	982
1989	945	3,915	4,860
1990	806	158	964
1991	772	108	880
1992	764	1,048	1,812
1993	1,303	927	2,230
1994	489	2,556	3,045
1995	1,440	651	2,091
1996	1,621	115	1,736
1997	1,096	192	1,288
1998	1,374	26	1,400
1999	1,783	2,241	4,024
2000	2,175	1,482	3,657
2001	3,163	2,346	5,509
2002	3,466	411	3,877
2003	3,589	2,347	5,936
2004	3,126	1,046	4,172
2005	2,699	2,575	5,274
2006	3,571	471	4,042

Source: Joseph Glauber. "Double Indemnity: Crop Insurance and the Failure of U.S. Agricultural Disaster Policy," American Enterprise Institute, 2007 (forthcoming).

out to producers. However, while farmers' insurance premiums are subsidized, they still paid an average of \$1.5 billion annually during these years to buy their coverage. Therefore farmers' net benefit from the crop insurance program was \$1.5 billion annually. The government's cost is the premium subsidies paid plus "delivery costs" paid to the insurance companies, which add up to \$4.0 billion annually in 2003-05. Thus the government incurs \$4.00 in budget costs for every \$1.50 in net benefits that producers receive. This is an inefficient transfer.⁴

⁴ Joseph Glauber, *op. cit.*, Table 7, provides calculations that show similar degrees of inefficiency in the whole period since 1990.

It might be argued that because farmers are risk averse, the value of having insurance available is higher than the money-value they get from it. However, we have ample evidence to demonstrate that the great majority of farmers will not buy crop insurance at unsubsidized market prices. Therefore it is unconvincing to argue that crop insurance has great non-monetary value to farmers that should be considered a net benefit to them.

Impacts on Land Use and Environment

Subsidizing crop insurance influences farmers' use of crop insurance and by the same token can be expected to influence land use related to the riskiness of production. A good test case of such effects was generated by the Disaster Payments Program of the 1970s. This program provided essentially free insurance to producers of program crops, anywhere in the country. In 8 counties of West Texas and Colorado there was a significant acreage of cropland before the Program went into effect, even though production in these counties was so risky that federal crop insurance was not sold in them. In the four years after the introduction of the Program, cropland acreage in these counties increased by 30 percent (in Texas and Colorado counties where crop insurance had been available, cropland acreage increased 20 percent).⁵

Recent increases in crop insurance subsidies are unlikely to have had effects this large on land use, but several recent studies have found evidence of increased crop acreages when subsidized crop insurance is available. A detailed study by economists at USDA's Economic Research Service estimates that as of the first decade of this century an average of 960,000 acres would be withdrawn from grain, soybean, and cotton production in the absence of subsidized crop insurance, with more than half of this acreage from the Great Plains.⁶ As with the Disaster Payments Program experience, it is apparent that the main crop acreage induced by subsidized insurance are, as one would expect, in the areas of highest weather risk such as the Great Plains. These are the same areas targeted under the Conservation Reserve Program for substituting soil-conserving practices for crop harvesting, the areas at highest risk of soil erosion when acreage is cropped intensively. So we have a tendency to be undoing with crop insurance subsidy policy what we are doing with conservation policy.

Summary

Subsidized crop insurance has an honorable history as an attempt to assist farmers in risk management. But it has proven far too costly in terms of costs to taxpayers per dollar of benefits received by farmers, has not precluded *ad hoc* disaster programs, and has induced production on type of marginal land that conservation policy is paying farmers to hold out of production. The nation would benefit from an end to the program.

⁵ For details, see B. Gardner and R. Kramer, "Crop Insurance Programs in the United States," in P. Hazell, C. Pomerada, and A. Valdes, eds., *Crop Insurance Programs for Agricultural Development*, Baltimore: Johns Hopkins Press, 1986, pp. 195-222.

⁶ C.E. Young, M.L. Vandever and R.D. Schneff, "Production and Price Impacts of U.S. Crop Insurance Programs", *American Journal of Agricultural Economics* 83 (2001): 1196-1203.