A 25 Year Milestone in Farm Policy

Looking back at the 1989 GAO report

"Those who don't know history are destined to repeat it."
-Edmund Burke

By Keith Collins and Tom Zacharias, NCIS and Farm Policy Facts Staff

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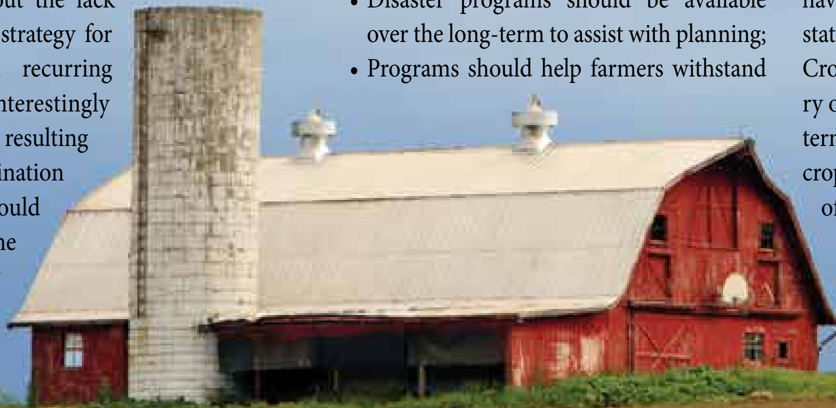
In the wake of weather disasters in 1983, 1984 and 1988, U.S. agriculture was struggling, and compounding the problem was an unparalleled farm debt crisis. America's food and fiber producers needed assistance, but aid was expensive and slow to arrive, causing hardship, not just in the countryside, but for taxpayers as well. On April 20, 1989, House Agriculture Committee Chairman E. "Kika" de la Garza had enough and asked the General Accounting Office (GAO) for help. Concerned that the federal government's responses to natural disasters had been "generally reactive and *ad hoc*," de la Garza raised questions about the lack of an overall strategy for dealing with recurring disasters. Interestingly enough, the resulting GAO examination and report would help pave the way for a new approach to agricultural policy—one that would ultimately protect almost 90 percent of planted cropland and help farmers weather disasters, including the 2012 drought, the worst on record since 1988.



Specifically, the GAO studied USDA's three main disaster programs, *ad hoc* direct disaster payments, disaster emergency loans and crop insurance, and compared their effectiveness using eight different criteria, including:

- The amount of assistance provided should be determined by the amount of loss;
- Programs should offer similar amounts to farmers for similar damage;
- Assistance to farmers should not exceed the value of their losses;
- Disaster assistance programs should not incentivize risk taking;
- Disaster programs should be available over the long-term to assist with planning;
- Programs should help farmers withstand and recover from natural disasters;
- Programs should have predictable costs; and,
- Programs should meet their objectives at the lowest possible cost.

The GAO found that while none of the programs satisfied all the criteria laid out, "crop insurance is a more equitable and efficient way to provide disaster assistance" than both direct disaster payments and emergency loans.

"Crop insurance treats disaster victims more equitably" and also "provides farmers disaster assistance more efficiently because farmers generally have more incentive to reduce risk under the program than they do under loan and direct payment programs."

That did not mean crop insurance did not have its flaws in the 1980s. The report further stated "…we recognize that FCIC (Federal Crop Insurance Corporation) has had a history of management problems that, in the short term, makes it difficult to justify the current crop insurance program as the sole source of disaster assistance to farmers," the GAO wrote. "Consequently, if the Congress chooses to rely on the crop insurance program exclusively to provide crop disaster assistance, a transition period

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for strengthening the program would probably be necessary."

Even as late as the early 1990s, crop insurance participation rates hovered in the 30 percent range and Congress was often spending considerably more each year in disaster relief expenditures than it was on crop insurance. In the summer of 1993, after eight months of heavy snow and hard rains, the Midwest was hit by record flooding and excessive soil moisture conditions. More than 21 million acres of farmland flooded resulting in more than $4 billion in damage. And while the Midwest suffered from too much moisture, the Southeast sizzled under scorching heat that withered crops in the field.

The Federal Crop Insurance Reform Act of 1994, which followed the devastating 1993 crop year and signed by President Clinton in October of 1994, restructured crop insurance to increase farmer participation, increase the private sector's role, enhance provisions of the crop insurance program for the farmer, and create the USDA's Risk Management Agency (RMA).

The landmark GAO report, written in 1989, recommended a strengthening of the crop insurance program in order to serve effectively as the sole program for providing farm disaster assistance. While Congress was writing the historic 1994 legislation, the Department of Agriculture released the "Blueprint for Financial Soundness," published in the *Federal Register* in April 1994. In this publication, the USDA identified key areas of needed improvement to the crop insurance program. Since then, these areas have been repeatedly addressed and strengthened. The areas identified include:

- **Determination of more accurate yields.** In the early years of the crop insurance program, a farm with insufficient data was often assigned an insured yield that exceeded its expected yield, leading to over-insurance and higher claims. A system of substitute yields was introduced that used more realistic proxy yields when a producer lacks a sufficient yield history. Rules for determining yields on aggregated and divided insurable units have been improved to ensure accuracy. Sophisticated acreage, production and yield reporting and tracking systems are now in place to assure farm yields are correctly determined and continuously monitored.
- **Better tracking of ineligible producers.** Today's crop insurance program identifies ineligible producers using the Ineligible Tracking System (ITS). Using social security numbers and employer identification numbers, the ITS is designed to identify producers who are ineligible to participate in any program administered by RMA. A producer may be placed on ITS for a delinquent debt to FCIC or an insurance company; conviction of a violation of the controlled substance provisions of the Food Security Act of 1985; or if disqualified, suspended, or debarred under the Federal Crop Insurance Act and related regulations. The tracking system is used through company IT applications to restrict producers who have been declared ineligible to obtain benefits provided by the Federal crop insurance program.
- **Premium rate adjustments.** The very high program losses of the 1980s and early 1990s led to continuous efforts to improve actuarial performance. There have been numerous changes in rating methods including: better classification of producer risks (for example, use of the Nonstandard Classification System); continuous rating; creation and use of STATPLAN, a single database drawn from various sources containing multiple year data that is most useful for risk analysis; and, contracting with actuarial consulting firms and rating experts to review all aspects of the actuarial methods and develop improvements. Congress also consistently tightened rating requirements by reducing the target loss ratio (defined as indemnities as a percent of premiums) from 110 percent in the mid-1990s to 100 percent today. Improved program performance in the late 1990s and 2000s has resulted in the actual loss ratio of the program over its life, 1981-2012, to now be 93 percent.
- **Improved underwriting.** The term underwriting covers a broad array of activities that involve assessing risk and establishing conditions for writing insurance. These activities include defining the circumstances that result in a covered loss, measuring the loss, and defining the responsibilities of the insurance company and the producer under the policy. Steady improvements have been made in underwriting standards, such as defining appropriate management practices for dryland and irrigated production, determining prevented planting rules, identifying high risk land, specifying conditions under which new lands are added to the policy coverage, and specifying prices used for revenue plans of insurance. Policy language, terms and conditions have been improved, better defined and described to reduce program vulnerabilities.
- **Better program compliance.** While both the government and the companies have strong financial incentives to ensure efficient program operation, numerous procedures have been put in place to ensure program compliance. Large-scale data mining and on-the-ground farm inspections, that include the Farm Service Agency, have been documented to have reduced losses by many hundreds of millions of dollars. Numerous program and policy checks have been implemented, including large claim reviews, conflict of interest reviews, Actual Production History (APH) verification reviews, consecutive loss adjuster reviews and individual policy and overall company operational reviews to assure compliance with regulations, policy and procedures. Substantial training requirements have been implemented and all loss adjusters must now be certified. Agents, loss adjusters, companies and others who fail to meet the standards of performance in program delivery and administration are now subject to suspension and debarment procedures.
- **Introduction of new products to improve participation.** Since the GAO high-

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lighted the strengths of crop insurance, many new products have been advanced that have improved quality and increased desirability of crop insurance across the nation. In the mid-1990s, area plans were introduced, and that was followed a couple of years later by the advent of revenue insurance, which now accounts for about 80 percent of the premium written. Steady progress has been made to cover underserved crops and regions, including specialty crops. The 508(h) process that allows private developers to obtain approval for sale of new products has provided flexibility in the product development process. NCIS estimates that between 2000 and 2013, there were 58 new products introduced into the crop insurance program by RMA and the 508(h) process combined. The 296 million acres enrolled in the program in 2013 is strong evidence of the widespread acceptability of the product offerings.

- **Increased risk bearing by AIPs.** The risk sharing arrangement between the Federal government and the companies (known as the Standard Reinsurance Agreement, or SRA) has changed substantially over the past two decades, with the share of risk borne by the companies increasing. For example, under the 1992 SRA, the maximum indemnities a company was responsible for was 156 percent of its retained premium. Under the current SRA, in the major states of Iowa, Illinois, Indiana, Minnesota and Nebraska, the maximum indemnities a company is responsible for are now 194 percent of its retained premium. In the drought year of 2012, the companies' underwriting losses were $1.3 billion, a record high. Of course, companies must also be given an opportunity to earn gains if they are going to be able to build surplus capital to finance the large losses in catastrophic years, such as 2012, and remain in operation.
- **Management actions to correct if changes are not working.** The Federal Crop Insurance Act was designed to provide RMA with wide regulatory authority, which enables RMA to work with companies to implement many program changes as the needs are identified. The program history is one of successively introducing new program and product improvements to increase the effectiveness and efficiency of the program. Congressional action is not usually necessary; however, periodic farm bills have been used to amend the Federal Crop Insurance Act and implement changes outside the legal authority of RMA.

As a result of these continued improvements, Congressional support, and the work of the industry and USDA, crop insurance grew significantly in its importance to U.S. farmers and ranchers. In 1996, the Federal Crop Insurance Corporation (FCIC) approved the first revenue plans of insurance, available for corn and soybean growers initially in Iowa and Nebraska. By 1998, more than 180 million acres of farmland were insured under the plan, representing a threefold increase over 1988. But coverage levels on a per acre basis were still low, such that Congress had not been able to break the habit of yearly *ad hoc* disaster bills.

Then, in May 2000, Congress approved new legislation in support of crop insurance: the Agricultural Risk Protection Act (ARPA) of 2000. The provisions of ARPA made it easier for farmers to access different types of insurance products, including revenue insurance and protection based on historical yields. In addition to making crop insurance more affordable for producers, ARPA initiated the 508(h) process for new product development.

By summer of 2012, more than 280 million acres were enrolled in crop insurance—just in time for the historic drought that would have otherwise crippled rural America. As a result of the continual improvements to modern-day insurance program, there have been no calls for *ad hoc* disaster bailouts—even after the Midwest floods and drought in the Southern Plains in 2011 and the extreme drought of 2012.

Farmers who purchase crop insurance do so knowing that, in the event of a loss, their claim will be adjusted and processed as quickly as possible; many claims are finalized and paid within 30 days. For example, in 2011, farmers in Texas received $2.6 billion in liabilities due mostly to drought. Of this, more than $1.3 billion was paid by mid-September of that year. In 2012, farmers across the drought-stricken U.S. quickly received indemnities for their insured losses and could repay operating loans. And best of all, taxpayers were not left funding the entire loss because private insurers shouldered more than $1 billion in underwriting losses, growers paid $4 billion for premiums out of their own pockets, and farmers absorbed nearly $13 billion in deductible losses before receiving a single dollar.

Looking back over the past 25 years, we can see how far the crop insurance program has come. Critics of the program would do well to head the advice of Mr. Burke; "Those who don't know history are destined to repeat it." As we go forward into 2014 and complete the Farm Bill, it is important for the crop insurance industry, the American farmer, and Congress to build upon our earlier successes and continue to improve crop insurance for the future.