

“...Where to now, St. Peter?”

Affordability Now

This is the second in a three-part series. The original article was published in the May 2014 issue of *Crop Insurance TODAY*®.



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Many of us recall the Seinfeld television series which aired for 10 years with 180 episodes. In sitting down to share my thoughts for this President's Message, I was reminded of Episode #159 "The Serenity Now" (aired October 9, 1997). In this particular episode, George's father was "prescribed" to utter the phrase "Serenity Now" when he felt his blood pressure spiking.

Here is an excerpt from the transcript of that episode:

Frank Costanza: "Serenity Now! Serenity Now!"

George Costanza: "What is that?"

Frank: "Doctor gave me a relaxation cassette. When my blood pressure gets too high, the man on the tape tells me to say, 'Serenity Now!'"

George: "Are you supposed to yell it?"

Frank: "The man on the tape wasn't specific."

Okay, enough levity and stream of consciousness. What does this have to do with crop insurance and the new Farm Bill?

As readers of this quarterly discourse may recall, in the last issue of *TODAY*® we asked "Where to Now, St. Peter?" as crop insurance has become the centerpiece of the farm safety net in the 2014 Farm Bill. In discussing the "Road" to be traveled, we focused on three key elements for crop insurance to be successful as we go forward. These elements are: 1) availability; 2) affordability; and 3) viability.

In the previous issue we discussed crop insurance availability. Crop insurance is now widely available in 3,135 counties nationwide with more than 120 different crop programs covering 296 million acres in 2013 with \$124 billion in crop protection liability. We also stressed the importance of the new Farm Bill as it established risk management-based crop insurance as the foundation of future agricultural policy. With passage of the Farm Bill, two new risk management products became available for private sector delivery: the Supplemental Coverage Option (SCO) and the Stacked Income Protection Plan (STAX). In addition to SCO and STAX, existing coverage will be enhanced with the Enterprise Unit discount moving from a pilot to a permanent program and the expansion of enterprise unit availability by practice. The Farm Bill also provides beginning farmers and ranchers with additional premium discounts and the benefit of higher insurable yields, making crop insurance more affordable and available to more growers.

So, back to our latest Seinfeld episode...we turn to "Affordability Now."

A Little Background on Affordability

Affordability goes hand-in-hand with availability. The progression of the modern day crop insurance program is in no small part due to the emphasis and investment Congress has made in making crop insurance products more affordable. Let us take a little walk down memory lane....

Historically, concern over the limited availability of insurance for farmers and insufficient capacity to cover catastrophic risks faced by private companies resulted in the Federal Crop Insurance

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Act in 1938. Under the Act, the Federal government began to provide multiple peril crop insurance to farmers. While the government covered delivery expenses, no premium subsidies were provided then. For the early years, participation in the Federal program was quite low. Low participation, coupled with a series of crop disasters during the 1960s and 1970s resulted in the Federal government providing farmers with costly disaster payments that were 100 percent subsidized, that is, taxpayer funded. The succession of disaster programs ultimately generated Congressional interest in improving crop insurance to replace costly, unpredictable, and off-budget disaster payments. This gave rise to the Federal Crop Insurance Act of 1980, which created the public-private partnership that we know today, with private companies delivering the program and the Federal government providing oversight and reinsurance capacity. Premium support for farmers was introduced with the 1980 Act, in hopes of increasing farmer participation. Beginning with 1981, producer premium was subsidized at 30 percent for coverage up to 65 percent of expected yield. No support was provided for premium for the portion of coverage above 65 percent of expected yield.

With the introduction of Federally provided premium support, crop insurance participation increased but remained low, primarily because of the presence of other government programs, available at no cost to farmers. At the time, traditional farm programs, coupled with disaster payments, were providing adequate farm income support. However, new legislation in 1994, 2000 and 2008 provided for increased levels of premium support, setting the stage to make crop insurance the primary risk management tool that farmers would depend upon. During this time frame, the scale and scope of disaster programs and traditional farm programs were gradually reduced. Today premium support or subsidy—referred to here as the premium discount—differs by the type of unit insured, coverage level and plan of insurance. For example, discount schedules are different for individual farm yield and revenue plans of insurance, area plans of insurance and livestock plans of insurance. Compared to traditional farm income support, with crop insurance, farmers do not receive a direct cash subsidy. Farmer premium is discounted and then farmers only receive a payment in the event of a verifiable crop indemnity.



Affordability in Perspective

Premium discounts, as a share of producers' income, vary by crop, region and insurance coverage level. To put this into context, it is useful to provide some estimates by crop and country-wide. For corn, the crop with the highest insured value, premium discounts totaled \$2.83 billion in 2013. Gross income, or production value, of the 2013 corn crop is now estimated at about \$62 billion, thus crop insurance premium discounts were equal to 4.6 percent of the crop value. For wheat, premium discounts totaled \$1.25 billion in 2013 and the gross value of production was \$14.63 billion, so premium discounts equaled 8.5 percent of production value. For all U.S. crops, premium discounts totaled \$7.29 billion in 2013, and gross income for farmers (total cash receipts from market sales) is estimated at \$216 billion. Thus, crop insurance discounts accounted for only 3.4 percent of overall gross income from all U.S. crops in 2013. Taking this a step further, farm support is less than two cents per meal and accounts for less than one quarter of one percent (approximately 0.19%) of the Federal budget. In perspective, premium discounts represent only a small relative share of the value of agricultural production or farm program outlays. Discounted crop insurance premiums are a good investment to help stabilize farm and rural economies.

Delivery Expense and Affordability

An important and often misunderstood

element of crop insurance affordability is the Administrative and Operating (A&O) payment. A&O payments are made to companies on behalf of the farmer to cover servicing and delivering the policy. These payments made to the Approved Insurance Providers (AIPs) have been oftentimes misrepresented as subsidy or profit to the industry when, in fact, the A&O payment is a key component of affordability. The payments go toward delivery expenses that the farmer would otherwise be required to pay. As financial pressure has increased in recent SRA negotiations and Farm Bills, A&O payments have been substantially reduced. Suffice it to say, reductions in A&O aimed at the delivery system could ultimately affect affordability in the long run *vis-à-vis* service levels provided by the industry. Not the subject of today's conversation, but in next issue of *TODAY*®, we will deal with private sector viability and the issue of A&O.

The Case for Affordability

The fundamental purpose of the premium discount and A&O payments is to make crop insurance affordable for farmers so that coverage is widespread and the need for disaster payments is eliminated. Government provides this support to farmers to increase their participation. Affordable premiums result in more widespread coverage, which reduces financial risk for farmers and taxpayers and contributes to the financial stability of the food production sector. With more widespread coverage, the pool of insured farmers is larger and more diverse. This allows for efficient spread of risk and keeps premiums lower in the long run.

Contrary to the critics, there is strong U.S. support for crop insurance premium discounts. How do we know this? First, since the 1980 Act, Congress has steadily increased the level of the farmer discount to achieve the policy objective of improving the level of crop insurance affordability enabling more farmers to purchase adequate coverage and thereby reducing the political demand for ad hoc disaster assistance. In February 2014, a new Farm Bill was enacted that will govern farm programs for the next five years. Deliberation over the bill included a healthy debate of the issue of premium support. Upon final passage of the bill, Congress maintained current premium support levels and provided new programs with additional premium support. This sustained level of Congressional assistance would not have been

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possible without overall public support. The new Farm Bill did reduce the funding for traditional price and income support programs, which more than offset the costs of the new crop insurance provisions.

In late March, after people had time to consider the new Farm Bill and what it offers, NCIS conducted a national opinion poll to assess the public's attitudes about agriculture and farm policy. The poll showed that the general public has a very favorable view of farmers and current farm policy. A majority of Americans support the use of crop insurance to manage farm risk, with farmers paying a portion of the cost and the government paying part, as opposed to traditional farm programs. Lastly, and interestingly enough, economic theory sheds some light on this issue. Ongoing economic analysis conducted at NCIS indicates that the use of subsidized crop insurance is socially preferable (optimal) from the government's perspective when compared to after-the-fact (ex-post) ad hoc disaster payments. ["Political Economy of Crop Insurance Risk Subsidies Under Imperfect Information," *Drs. Harun Bulut and Keith Collins, presented paper at the Agricultural and*

Applied Economics Association meeting, August 4-6, 2013, Washington, D.C.] In essence, economic theory further substantiates that discounting farmers' use of crop insurance has a public benefit.

Where to Now?

Unfortunately, no sooner than the ink was dry on the new Farm Bill, critics attacked crop insurance in the appropriations process, including a proposal to cut an additional \$23 billion from crop insurance on top of the overall cuts for production agriculture contained in the 2014 Farm Bill. Crop insurance affordability will be greatly influenced by the continuing efforts to reduce Federal budget deficits. These efforts will also be a continuing source of debate over the appropriate level and structure of premium discounts and how farmers will be eligible to receive them. Supporters of crop insurance and industry stakeholders must be ever vigilant to ensure that crop insurance remains affordable in order to promote a financially healthy farm sector.

In closing, crop insurance has come a long way and is now the essential element of the farm safety net. Availability and affordability

must remain key to continued success of the crop insurance program. In our next issue we will discuss the importance of private sector viability.

With that, we hope you enjoy this issue of TODAY® that contains the second article in a two-part series on PRISM, a detailed climate and weather system developed by Oregon State University and used by several crop insurance companies for verification of crop losses. The 2013 NCIS agronomic research results are summarized and there is an in-depth look at the NCIS Crop-Hail Wheat and Corn School written by NCIS' summer intern, Hannah Wiebelhaus. We also provide a look at how the industry is working with RMA to implement the 2014 Farm Bill and there is a summary of the 2013 MPCI and Crop-Hail premium and loss ratio data. Just shy of 50 pages, the August issue is packed with great information for everyone.

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