



List of Alternatives Being Discussed to Reduce Farm Premium Subsidies in Crop Insurance

Carl Zulauf

Department of Agricultural, Environmental and Development Economics
The Ohio State University

Gary Schnitkey

Department of Agricultural and Consumer Economics
University of Illinois

Art Barnaby

Department of Agricultural Economics
Kansas State University

February 6, 2013

farmdoc daily (3):22

Recommended citation format: Gary Schnitkey, C. and A. Barnaby. "List of Alternatives Being Discussed to Reduce Farm Premium Subsidies in Crop Insurance." *farmdoc daily* (3):22, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, February 6, 2013.

Permalink: <http://farmdocdaily.illinois.edu/2013/02/list-of-alternatives.html>

Cost of crop insurance programs may be an issue this year, either via the farm bill or other legislation. Regardless, discussion of its cost is increasing. Moreover, it seems likely that the cost of crop insurance will become more prominent in future farm safety net discussions. The reason is simple: it is the largest cost program in the farm safety net. Moreover, crop insurance is no longer a small spending program. U.S. policy deliberations differ for large and small spending programs. Discussions of small spending programs focus on the program's value to beneficiaries. In contrast, discussions of large spending programs focus on whether the program is fair and appropriate for both beneficiaries and the U.S. public.

This paper's objective is to make readers aware of the variety of discussions that are going on with regard to alternatives for reducing the cost of farm premium subsidies, the largest cost item in crop insurance. This list contains alternatives that the authors have heard mentioned. They are roughly presented in order of potential cost savings. The discussion is not comprehensive, nor does it consider whether cuts will occur this year or in the future as well as whether cuts will be made elsewhere in the farm safety net, including crop insurance administrative and operating expense. The list is not meant as recommendations; its purpose is to make you aware of the discussion.

Each alternative may impact the actuarial soundness of crop insurance, the possibility that ad hoc disaster assistance is provided, and different crops and areas of the country differentially. It is important to assess these impacts so that a better informed decision is made. A few selected examples are provided as illustrations of the type of analyses that would be desirable.

We request all readers, electronic media and others follow our citation guidelines when re-posting articles from *farmdoc daily*. Guidelines are available [here](#). The *farmdoc daily* website falls under University of Illinois copyright and intellectual property rights. For a detailed statement, please see the University of Illinois Copyright Information and Policies [here](#).

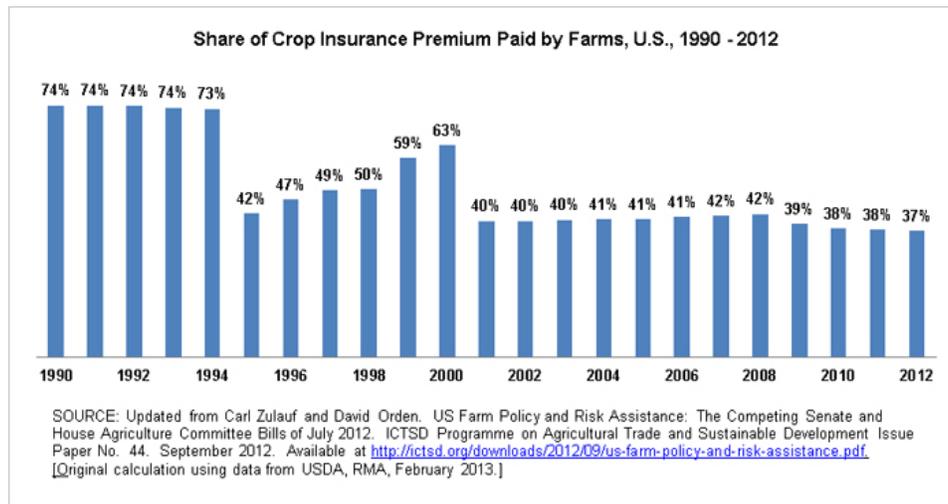
Subsidize only Yield Risk Insurance

This alternative stems from a policy philosophical question: Since farmers have access to private market alternatives for price protection (futures, options, forward contracts, etc.), should government also provide price protection? In contrast, the private market offers few contracts to protect against yield decline. Dr. Bruce Babcock of Iowa State University has estimated that yield-only insurance would have reduced the cost of farm premium subsidies by around 50% for the 2011 crops (see [here](#)).

Increase the Share of Premium Paid by Farms

This alternative stems from the question whether the decline in the share of premium paid by farms has gone too far: from 74% in the early 1990s to 37% in 2012? (see graph) Size of the savings will depend on the size of the subsidy reduction and whether the reduction is uniform or differentiated by product and coverage level.

A related question is whether CAT (catastrophic) insurance should remain free?



Offer Revenue-Only Insurance

This alternative stems from a policy philosophical question: What type of insurance does the public think is fair to support? Revenue-only insurance would base payments on whether revenue at harvest is less than expected revenue, less the deductible. It would be similar to Revenue Protection without the harvest price option A simple analysis using trendline state yields (from National Agricultural Statistics Service) and insurance prices for 1974-2012 for corn, soybeans, sorghum, upland cotton, rice, and wheat (Chicago wheat price) suggests revenue-only insurance would reduce federal expenditures on farm premium subsidies by 25% to 40%. Eliminating HPO might lead to less forward contracting by farms, but the current HPO subsidy may be leading to too much forward contracting. Eliminating HPO also would reduce the value of crop insurance for farms that feed their crops to livestock.

Reduce Cost of HPO

The cost of HPO could be reduced by having a lower subsidy rate for it or by limiting the amount of production eligible for subsidized HPO. For example, subsidized HPO could be limited to 30% of expected yield or could be limited to farms that grow feed for livestock on their farm. HPO would still be available at an unsubsidized rate for other production.

Vary Subsidy Rate by Size of Farm

This alternative arises from a policy philosophical question: Should large farms receive the same subsidy as small farms? This issue repeatedly appears in farm policy debates and is the underlying reason payment limits exist for most other farm safety net programs. The U.S. Senate's 2012 Farm Bill contained

a provision sponsored by Senators Tom Coburn, Republican of Oklahoma, and Richard Durbin, Democrat of Illinois, to reduce the premium subsidy by 15% for farmers (or legal entities) with adjusted gross income above \$750,000. Reducing the subsidy for large farms may cause insurance premiums to increase for all farms if farms that exceed the limit generate gains for insurance and if higher farm-paid premiums cause them to self-insure instead of buying insurance.

Change Crop Insurance Parameters Related to Individual Situations — examples are (1) lower payment rates for prevented planted acres and (2) lower minimum insurance t-yield.

These types of changes will differentially affect farms based on the probability that the situation happens to them. For example, farms in areas of the country in which prevented planting is more common will be most affected by reducing the payment rate for prevented planting.

Eliminate Optional Insurance Units

This alternative arises from a policy philosophical question: What is the appropriate farm area unit on which to place a subsidy? The extremes are the individual field (i.e., optional units) and the whole farm. Eliminating optional unit transfers more risk management to the individual farm because the loss in any one field is averaged across a larger area, such as the farm enterprise unit or whole farm. Variability of production is greater at the field than at the enterprise or whole farm level. Hence, this change should reduce insurance payouts and thus the cost of the insurance program.

Improve Underwriting and Adjust Rates on the Assigned Risk Pool

An example that falls under this approach is to put a farm premium surcharge on policies that companies put in the assigned risk pool. Policies are usually assigned to the assigned risk pool because companies think the policies are underrated or needs more underwriting. Hence, it is not unreasonable to ask if these policies should pay a premium surcharge. Another example is to ask if the Risk Management Agency can better incorporate the accumulating data on individual performance. Many fields and farms now have 10 years plus of crop insurance performance data.

Enact Conservation Compliance for Crop Insurance

Requiring conservation compliance will reduce the cost of crop insurance. Some farms will opt not to meet conservation compliance and thus will be ineligible for the insurance subsidy. Savings are likely to be modest but might be meaningful when environmental benefits are included.

The paper is also available at

<http://aede.osu.edu/publications>

http://www.agmanager.info/crops/insurance/risk_mgt/rm_pdf13/AB_Alternatives.pdf