The Revenue "Insurance" Boondoggle

Mission Creep

Crop insurance has quietly morphed from what most people would consider a safety net—insurance against crippling crop losses—to a federally-guaranteed business income for some of the most profitable and financially secure enterprises in the nation.

Today, farmers have two choices:

-- **Yield protection** insurance, available since the 1940s, pays when yield drops below a level selected by the farm business. The insurance payout equals the number of bushels the crop is short times a projected market price established by the U.S. Department of Agriculture's Risk Management Agency.

Example

An Iowa farmer takes out a traditional yield protection policy that insures 80 percent (144 bushels per acre) of his average corn crop yield of 180 bushels per acre. If his actual yield is less than 144 bushels, he gets an insurance payout. In this example, a corn yield of 120 bushels would trigger a payment of $136 per acre. [24 bushels short (144-120 bushels) * $5.68 (projected market price per bushel) = $136].

The insurance policy costs $29 per acre, of which the farmer pays $15 and federal government subsidizes $14.

-- **Revenue protection** insurance, a relatively new product that insures price as well as yield. About 83 percent of American farms have switched to revenue protection policies because they are more generous, paying whenever crop prices drop, yield declines -- or some combination of the two.

Example

The same Iowa farmer signs up for a revenue protection policy that insures 80 percent of his projected revenue of $1,022 per acre [average annual yield of 180 bushels per acre * $5.68 (projected market price per bushel) = $1,022]. The policy would pay if his "actual" revenue falls below $818 per acre. Actual revenue is calculated by multiplying the farmers actual yield times the established "harvest price" set by the Risk Management Agency.

If, for example, the farmer's yield is 155 bushels per acre and RMA establishes a harvest price of $4.40 per bushel, his actual revenue for insurance purposes, $682 per acre, is less than the $818 per acre guarantee. The policy would pay the difference, $136 per acre. [$818 revenue guarantee - $682 actual revenue = $136].

The revenue insurance policy costs this Iowa farmer $56 per acre, nearly double the price of crop insurance, and is more heavily subsidized: the farmer contributes $29 per acre and the taxpayer picks up the $27 balance.

The yield loss in this scenario is too small to trigger a payout from the yield protection policy in the first scenario. The revenue protection policy pays because price as well as yield are insured.

Exploding costs

At first glance, asking taxpayers to insure farmers against plunging prices as well as yield losses appears to be a useful addition to the governmental safety net. But this mission creep has caused big problems.

Overall taxpayers cover about 60 percent of premiums for farmers' revenue protection plans. The federal outlay for these premium subsidies has exploded from $1.5 billion in 2002 to $7.4 billion in 2011. An analysis by agricultural economist Bruce Babcock concludes that the industry-wide shift from yield protection to more heavily subsidized revenue protection has doubled the federal crop insurance program and has cost taxpayers far more than "direct payments," the most expensive traditional farm subsidies.

Babcock finds that the federal premium subsidy, averaged across all revenue protection policies was:

- $40/acre for corn; $16 more than the $24/acre direct payment.
- $27/acre for soybean; $15 more than the $12/acre direct payment.
- $26/acre for wheat; $11 more than the $15/acre direct payment.
- $72/acre for cotton; $38 more than the $34/acre direct payment.

Insurance companies reap billions

U.S. taxpayers paid $1.5 billion last year and $7.1 billion between 2007 and 2012 to highly profitable insurance companies -- some with headquarters in Switzerland, Australia, Ireland, Japan and Bermuda -- to reimburse so-called "administrative and operating expenses." Therefore, the taxpayer is paying twice—once to subsidize the farmer's premium and again to encourage companies to sell crop insurance.

Top 15 Crop Insurance Companies Receiving Reimbursement 2007-2012

Parent/Holding Company (Location)	US payment	Parent/Holding Company (Location)	US payment
Wells Fargo (USA)	$1,729,766,387	Renaissance Reinsurance Ltd. (Bermuda)	$169,655,434
Ace Ltd (Switzerland)	$1,540,203,488	Farm Bureau (USA)	$206,116,408
QBE Insurance Group (Australia)	$836,509,383	Westfield Insurance Company (USA)	$105,434,070
American Financial Group (USA)	$662,713,730	American International Group of Companies (USA)	$80,923,916
Endurance Specialty Holdings Ltd. (Bermuda)	$452,227,910	Archer Daniels Midland Company (USA)	$80,128,490
Farmers Mutual Hail Insurance Company (USA)	$281,216,604	Country Financial (USA)	$75,006,862
Service Lloyds Insurance Company (USA)	$390,204,033	ITOCHU Corporation, ZEN-NOH Grain Corporation (Japan)	$55,173,858
XL Group Plc (Ireland, Bermuda)	$226,813,626		

Paper losses

Revenue protection policies create the potential for large payouts for farmers' paper losses because the Risk Management Agency doesn't know or ask how much policyholders actually made when they took their crops to market. The agency assumes all producers sell their crops for the same so-called "harvest" price -- an index of futures prices. In the real world, most farmers sell their grain before or after harvest -- very often at prices far higher than the government's artificial "harvest" price. Between 2000 and 2010, the average price corn farmers actually received when they sold their crops was higher than the "harvest" price two-thirds of the time. The average actual price farmers got for soybeans was higher than the harvest price 49 percent of the time and the average actual rice price exceeded the harvest price 50 percent of the time. Larger farm businesses using sophisticated marketing systems likely sold their crops at far higher prices.

Environmental Harm

Crop insurance subsidies encourage expanded cultivation and pollution. According to USDA's Economic Research Service, higher crop insurance subsidies in the mid-1990s created a powerful incentive for farmers to convert an estimated 2.5 million acres from hay and pasture to crops. As a result, the USDA analysts said, land converted to or maintained in production as a result of crop insurance subsidies was "associated with higher levels of potential nutrient losses per acre...policies that increase incentives for crop cultivation and stimulate production on economically marginal land may have disproportionately large unintended environmental consequences."

Is crop insurance sacrosanct?

Ardent supporters of crop insurance argue that the 2008 farm bill cut the program by $3.9 billion over the FY 2008-2012 period, compared to the previous farm bill, and should not be further reduced. According to the Congressional Research Service, $2.8 billion, or 70 percent, of the savings are nothing more than a budget gimmick generated by carefully timing receipts and payouts. The 2010 agreement between USDA and crop insurance companies is also cited as the source of another $6 billion in "cuts" because it capped administrative and operating expense subsidies at $1.3 billion a year.

Babcock found that the agreement reduced – but did not come close to eliminating –windfall profits that agents and companies had enjoyed since 2006. He concluded:

> *Congress could make major changes to the crop insurance program and still retain a fair and highly effective safety net that saves tens of billions of dollars.*

The Environmental Working Group supports a safety net for working farm and ranch families. The question is basic fairness. How much of the cost of that insurance should taxpayers pay? And who should get taxpayer-subsidized protection? Anyone? Or only those farmers who really need the help?