Crop Insurance Systems in Other Countries

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After agriculture experienced a decade of unmatched prosperity, topped-off with record profits in 2013, the recent farm bill reauthorization presented an opportunity to create a more cost-effective and transparent agricultural safety net that is both accountable to taxpayers and responsive to modern production and practices. Instead, turning a blind eye to our $17 trillion national debt, proponents of heavy government intervention in agriculture adopted a nearly trillion-dollar farm bill that increases taxpayer spending on insurance-like programs for agriculture, including new subsidized crop insurance policies, coverage for additional crops, and the creation of new "shallow loss" income entitlement programs.

As the 2014 farm bill is implemented, lessons can be learned from other countries which somehow have vibrant agricultural sectors despite the fact that they don't subsidize domestic crop insurance programs. In fact, the agriculture sector is thriving in New Zealand, a country that offers no crop insurance subsidies and discontinued all farm subsidies in the 1980s.

Instead of attempting to placate special interests, Congress should instead look to alternative risk management options in other countries to help reduce our debt and eliminate numerous unintended consequences resulting from current farm subsidy programs. At a minimum, the U.S. should set a goal for agribusinesses to take on a greater role in the management of their business decisions. As an example, instead of incentivizing producers to write off income and incur greater expenses to reduce annual tax liability, farmer savings accounts could be implemented to promote saving for less profitable growing years; Canada and Australia operate successful farmer savings accounts while U.S. producers face the opposite incentives.[1] While numerous other options exist, here we will examine alternative crop insurance systems found in other countries.

Comparison of U.S. Crop Insurance Model to Other Countries

While the U.S. crop insurance program exhibits some similarities with other countries, there are numerous and dramatic differences. U.S. crop insurance companies, like those in other countries including many in the European Union (EU), offer unsubsidized hail and wind insurance policies and increasingly, new policies that use weather indexes, for instance, to help calculate potential insurance payouts.[2] Some countries also offer subsidies for yield insurance policies which make payments after severe droughts, floods, or other disasters. Finally, most countries offering crop insurance subsidize policies to incentivize producers to enroll.

Similarities, however, generally end there. Differences between crop insurance models in the U.S. and other countries include the following:

- The U.S. is the only country providing billions in subsidies for **publicly-subsidized, gold-plated revenue based insurance** which can kick in even after a bountiful harvest; in fact, in 2012, 88 percent of all U.S. loss payments were paid on revenue policies (which can be triggered due to a loss or crops or price dips) while only 11 percent were paid solely due to yield losses.[3] Many producers would be less likely to choose the more expensive revenue policies if not for unlimited taxpayer subsidies. The only other countries providing revenue guarantees include: Canada which recently began to offer revenue insurance but at very low levels; Iran which offered some crop revenue subsidies as of 2008; and Sweden which offers revenue policies *without* taxpayer subsidies.[4]

- In the U.S., the **government operates as the financial backstop** for crop insurance and takes on the riskiest crop insurance policies, while reinsurance (insurance for insurance companies) in countries ranging from Bolivia to Sweden is provided solely by the private sector. Crop insurance in the U.S. is effectively a government program with a private façade: the program is administered at the federal level while private crop insurance companies receive lucrative subsidies to sell and service policies. U.S. taxpayers also pick up greater losses in poor growing years.
- While **high average levels of subsidies** exist in countries such as Italy (80 percent) and Spain (70 percent), these are the exception, not the rule. On average, U.S. taxpayers subsidize 62 cents out of every dollar of insurance coverage, but catastrophic policies compensating severe yield losses are subsidized at 100 percent (requiring of purchasers only payment of a small administrative fee). So, comparing apples to apples, U.S. subsidies are generally higher than in any other country although most other countries subsidize their crop insurance sectors. U.S. taxpayers also cover small dips in business income which is unprecedented around the rest of the world. On the other end of the spectrum, several countries – Australia, Germany, the United Kingdom, and Switzerland – provide no federal subsidies for crop insurance whatsoever.[5]
- The 2014 farm bill creates two new **"shallow loss" income entitlement programs** within the crop insurance program to cover dips in business revenue that are too minimal to trigger payments under traditional crop insurance policies. The Supplemental Coverage Option (SCO) and Stacked Income Protection Plan (STAX), which is available only to producers of upland cotton, will produce payments with as little as a 10 percent dip from expected revenue; taxpayers cover 65 and 80 percent of the premium, respectively.
- No other national crop insurance model comes close to the **level of overall taxpayer support in the U.S.** - $14 billion government cost in FY12 – which is paid via a one-way spigot from the Treasury.
- U.S. crop insurance is **administered by the federal U.S. Department of Agriculture** while countries such as Canada run their program through provincial governments or other entities.

Effects of Subsidizing Crop Insurance at Unlimited Levels

Several unintended consequences result from such heavy federal government intervention in agriculture, particularly unlimited crop insurance subsidies for some of the largest U.S. agribusinesses:

- **Taxpayers pick up a greater share of risk taking** while producers assume less risk for their own business decisions; this results in riskier planting decisions such as tearing up native grassland and draining wetlands to maximize production at the expense of long-term land productivity.

- **Moral hazard and adverse selection** occurs because agribusinesses have more information about the probability of losses on their cropland as compared to the insurer; thus, federal costs skyrocket as taxpayers end up subsidizing the riskiest farmland and poor management practices.[6]
- **Private sector risk management options are crowded out of the market** as producers instead opt for federally subsidized farm programs.[7]
- **Duplicative payouts** from federally subsidized crop insurance and other subsidies such as direct payments, government-set price floors, shallow loss programs, and disaster payments result in higher taxpayer costs and overlapping subsidies.
- **Agribusinesses become more specialized** and rotate crops less often because most subsidies are offered to five major crops – corn, soybeans, wheat, cotton, and rice.
- **Unlimited crop insurance subsidies** allow large agribusinesses to reap the most taxpayer support, resulting in higher land prices and more barriers for beginning farmers.[8]
- **At times, highly subsidized revenue guarantee policies compensate agribusinesses for relatively small market swings** instead of severe losses caused by droughts or floods, the supposed purpose of federal crop insurance.

Conclusion/Recommendations

The U.S. must reform its farm safety net to make it more accountable, cost-effective, transparent, and responsive to taxpayers. Instead of increasing the federal government's role in agriculture by expanding crop insurance and adding new, expensive, and unnecessary shallow loss income guarantee subsidies to the farm safety net, Congress should instead pare back unnecessary and wasteful farm subsidies and invest only in programs that provide positive public benefits at least cost. Without sacrificing an adequate safety net for farmers, the federal role in agriculture can be tempered by increasing private sector responsibility. U.S. crop insurance should be run more like private insurance, which nearly every other American business purchases to reduce risk. Implementing the following reforms would save taxpayers billions of dollars annually:

- **At a minimum, allow crop insurance companies to compete** when setting crop insurance premiums and vying for government administrative and operating subsidies (currently, the government sets premium rates which cannot vary from one company to another, and administrative subsidies cost the same amount each year regardless of the number of policies insured or the cost of operating the program);[9] numerous countries, including Australia and several EU countries, allow companies to compete on price.[10]
- **Allow the private sector to carry more risk and/or reinsure crop insurance policies** to reduce the taxpayer burden (currently, the government is required to back the riskiest policies); also, do not duplicate policies that the private sector already provides such as options or other risk management options which provide protection against dips in prices or revenue.[11]
- **Improve actuarial soundness of the program** by reducing waste, fraud, and abuse and allowing crop insurance premiums to reflect actual risk of losses (currently, independent analysts such as the Government Accountability Office question the accuracy of crop insurance payments, and agribusinesses can receive millions in subsidies to plant crops on poor farmland).[12]

- **Allow private companies to reject potentially new costly and risky policies** that provide little public benefits but instead cause numerous unintended consequences (currently, companies cannot reject any crop insurance clients so the riskiest policies are instead assigned to taxpayers).
- **Eliminate subsidies on the most expensive, unnecessary, and risky policies** such as those that are unnecessary, affect farmers' production decisions, insure land in hilly, dry, or flood-prone areas, guarantee high levels of expected agribusiness revenue instead of only kicking in after disasters (including the harvest price option which allows producers to receive higher price guarantees at harvest than they originally planned in the spring), or the practice of separately insuring individual fields and crops (optional units), as opposed to whole farms, to increase the likelihood of taxpayer-subsidized payouts.[13]
- **Eliminate subsidies for policies guaranteeing more than 70 percent of income** to bring the U.S. program in line with World Trade Organization (WTO) regulations (currently, because U.S. crop insurance subsidies are trade distorting and based on current planting decisions, they are "amber boxed," but given how the U.S. reports the subsidies, the entire taxpayer cost of the program isn't fully accounted for).[14]

Other options to rein in the exploding cost of crop insurance and make the program more accountable to taxpayers include:

- **Encourage the uptake of other private risk management options** such as diversification, vertical integration, mutual funds, and futures market, many of which are utilized in other countries instead of taxpayer-subsidized farm subsidies.
- **Implement means testing and premium subsidy limits** to ensure the most profitable agribusinesses pay for their own risk management. Other countries such as Poland, Chile, Italy, and Brazil limit premium subsidies whereas the U.S. currently provides unlimited crop insurance subsidies to any agribusiness.[15]
- **Require the use of best management conservation practices in exchange for any taxpayer support** to reduce downstream costs of agricultural pollution, conserve land for future generations, and reduce taxpayer liabilities. These time-tested, industry-standard, and risk-reducing practices include rotating crops, conserving wetlands, using conservation tillage practices, planting cover crops, among others.

For more information, visit www.taxpayer.net, or contact Joshua Sewell, josh at taxpayer.net.

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[1] http://www.oecd.org/tad/agricultural-policies/45558582.pdf
[2] http://ec.europa.eu/agriculture/analysis/external/insurance/chapter1.pdf
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[10] http://ec.europa.eu/agriculture/analysis/external/insurance/chapter6.pdf, http://siteresources.worldbank.org/FINANCIALSECTOR/Resources/CountryOverviewMasterPiece_final_ANNEX_E.pdf

[11] http://www.aei.org/files/2011/11/04/-something-for-nothing-direct-payments-and-title-i-farm-programs_151758774183.pdf

[12] http://www.gao.gov/products/GAO-05-528

[13] http://www.aei.org/files/2011/11/04/-something-for-nothing-direct-payments-and-title-i-farm-programs_151758774183.pdf

[14] http://ec.europa.eu/agriculture/analysis/external/insurance/chapter1.pdf, http://www.fapri.missouri.edu/outreach/publications/2011/FAPRI_MU_Report_01_11.pdf

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