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Briefing Report to the Chairman, Subcommittee on Agricultural Production and Stabilization of Prices, Committee on Agriculture, Nutrition, and Forestry, U.S. Senate

August 1988

CROP INSURANCE

Program Has Merit, but FCIC Should Study Ways to Increase Participation

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Resources, Community, and Economic Development Division

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August 15, 1988

The Honorable John Melcher
Chairman, Subcommittee on Agricultural
Production and Stabilization of Prices
Committee on Agriculture, Nutrition,
and Forestry
United States Senate

Dear Mr. Chairman:

In response to your March 23, 1988, letter and subsequent discussions with your office, this briefing report addresses (1) the merits of crop insurance and (2) steps that the Federal Crop Insurance Corporation (FCIC) could take to help increase participation in its crop insurance program. You expressed interest in making long-term improvements to the program, as well as correcting particular short-term operational difficulties. You also expressed concern that program discrepancies identified in our past reports may be used to diminish the FCIC crop insurance program's effectiveness. You therefore asked us to take a broader view of the program to determine its future course and development.

FCIC's program provides insurance to farmers to protect them against unavoidable crop losses caused by adverse weather, insects, plant disease, and other natural disasters. Over the years, the program has been designed to become the nation's primary disaster assistance program available to farmers. The program's rapid growth, as well as FCIC's efforts to maximize the role of private companies in selling and servicing crop insurance policies, has brought about several managerial and operational problems. In addition, farmers are not buying crop insurance to the degree originally envisioned for the program, leaving many without financial protection against crop loss. Recognizing that these problems exist, we nevertheless maintain that the overall merits of crop insurance continue to make it superior to other forms of disaster assistance, including loans and direct payments, and we believe FCIC could move in a direction to help increase participation in its crop insurance program.

INSURANCE IS THE BEST WAY TO PROVIDE DISASTER ASSISTANCE

We have been on record since 1980 supporting the overall merits of crop insurance.[1] While we have issued several reports that are critical of FCIC's management and implementation of its crop insurance program, these reports in no way diminish the fundamental merits of this program.

In comparing the three generic forms of subsidized assistance available to America's farmers--insurance, loans, and direct payments--insurance is the most efficient and equitable method for providing federal disaster assistance. Essentially, insurance is most efficient because it is best at providing information about risks which, in turn, enables farmers to make more rational decisions about their farm operations and the amount of risk they may or may not be willing to assume. Insurance is most equitable because, over time, it provides disaster victims with similar levels of assistance at similar levels of cost, regardless of the victims' income levels. In contrast, with direct payments and loans, ad hoc changes in program provisions often occur in the wake of widespread natural disasters--such as hurricanes--that create inconsistencies. For example, in three such events involving disaster loans, changes were made in interest rates and principal or interest cancellations.[2]

In addition to these factors, insurance has other advantages over direct payments and loans. Insurance, for example, provides more stable funding of disaster losses. (See section 1.)

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[1]Federal Disaster Assistance: What Should the Policy Be? (GAO/PAD-80-39, June 16, 1980).

[2]Further concern about the use of loans for providing disaster relief to farmers is discussed in our 1987 report, Farmers Home Administration: Problems and Issues Facing the Emergency Loan Program (GAO/RCED-88-4, Nov. 30, 1987).

A STUDY IS NEEDED TO HELP FCIC INCREASE PARTICIPATION

In our recent report on crop insurance participation,[3] we stated that in 1987 the level of participation in FCIC's program was only about one-half the 50-percent level envisioned by the House Agriculture Committee when the program was expanded in 1980. Among the many reasons cited by crop insurance experts for low participation in the program were (1) some farmers are unwilling or unable to bear the costs of crop insurance because of the poor condition of the farm economy; (2) many farmers believe that crop diversification is an adequate risk management tool; and (3) other federal programs provide farmers with direct cash payments at no cost, resulting in a perception that crop insurance is unnecessary. These experts also provided several suggestions for increasing participation in the program, ranging from changing the rate structure to making crop insurance a condition for participating in other farm programs.

As stated also in our July 1988 report, FCIC had not performed any nationwide studies to address the nonparticipation issue. Given these findings, we recommended, among other things, that the Secretary of Agriculture require the Manager of FCIC to conduct a statistically sound, nationwide study to determine which of the major factors influencing participation could or should be addressed. The results of this study could be used to focus FCIC's sales and promotional efforts on those areas and crops with the highest amount of increased sales potential. The Congress could also use this information in considering program changes that might affect participation rates. (See section 2.)

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In preparing this briefing report, we cited statements from our June 1980 and July 1988 reports (see footnotes 1 and 3, respectively). Because the Department of Agriculture officials had already commented on those reports, we did not obtain additional agency comments. We conducted our work between July and August 1988.

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[3] Crop Insurance: Participation in and Costs Associated With the Federal Program (GAO/RCED-88-171BR, July 6, 1988).

We are sending copies of this report to the Secretary of Agriculture; the Director, Office of Management and Budget; and other interested parties. Copies will be provided to others upon request. If we can be of further assistance, please contact me at (202) 275-5138.

Major contributors to this report are listed in appendix I.

Sincerely yours,

John W. Harman

John W. Harman
Associate Director

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ABBREVIATIONS

FCIC	Federal Crop Insurance Corporation
GAO	General Accounting Office
PAD	Program Analysis Division
RCED	Resources, Community, and Economic Development Division

SECTION 1

CROP INSURANCE IS THE MOST EFFICIENT AND EQUITABLE METHOD FOR PROVIDING DISASTER ASSISTANCE

We reported to the Senate Budget Committee in 1980 that insurance, in comparison with direct payments and loans, was the most efficient and equitable way for the federal government to provide disaster assistance.[1] By efficient, we mean that insurance is best at providing information about risks which, in turn, enables farmers to make more rational decisions about their farm operations and the amount of risk they may or may not be willing to assume. By equitable, we mean that insurance is more consistent in providing assistance among victims of different disasters, among similarly affected victims of the same disasters, and over time. In contrast, with direct payments and loans, ad hoc changes in program provisions often occur in the wake of widespread natural disasters--such as hurricanes--that create inconsistencies. For example, in three events involving disaster loans, changes were made in interest rates ranging from 1 to 6 percent, and in principal or interest cancellations ranging from $1,800 to $5,000 per loan.

In addition to these factors, insurance has three other advantages over direct payments and loans:

1. Since insurance rates are based on actuarial data, an insurance system forces those providing the insurance to anticipate catastrophic events, thus providing for more stable funding of disaster losses. Such action is not possible with direct payments and loans because they are made after the disaster occurs.

2. With a federal insurance program, there need be only one value judgment--the level of subsidization of the insurance premium. In contrast, with direct payments and loans, several value judgments come into play. These judgments determine, for example, the terms and timing of assistance provided for major disasters. Such judgments are not necessarily related to the actual severity of losses but instead to the overall amount of loss, which may bear little relation to the relative amount of individual suffering.

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[1] The report, Federal Disaster Assistance: What Should the Policy Be? (GAO/PAD-80-39, June 16, 1980), was done at the request of the Chairman and Ranking Minority Member of the Senate Committee on the Budget.

3. In comparison with loans, insurance minimizes the unequal treatment of similarly affected victims that can be introduced by the progressive nature of our tax system. Although with the 1986 tax reform legislation, unequal treatment may not be as significant as it used to be, in general, taxpaying victims can recoup part of their uncompensated losses, through lower taxes, by deducting those losses from their income when they compute their income taxes. These victims may also be able to deduct the interest they pay on loans. In a progressive tax system, such deductions are worth more to someone in a higher marginal tax bracket, because for that person a deduction of a given amount will cause a larger reduction in taxes due. Given this tax structure, with loans, lower income victims absorb a larger proportion of their losses than higher income victims. However, with insurance, if premiums are subsidized in equal proportions irrespective of income--which is the case with crop insurance--then similarly affected victims will be treated equally, to the extent that their losses are covered. For losses that remain uncompensated by insurance, higher income victims will still be able to recoup a larger share through reduced taxes.

SECTION 2

FCIC NEEDS TO STUDY HOW BEST TO INCREASE PROGRAM PARTICIPATION

In July 1988, at the request of Senators Sarbanes, Biden, Boren, Burdick, and Mitchell, we issued a report that discussed the level of participation in FCIC's crop insurance program.[1] As part of that effort, we determined the 1987 participation rates for 31 insurable crops in 10 states.[2] For the most part, we computed participation rates for each crop by dividing the gross insured acres by planted acres. By state, the rates varied considerably, from a low of 2.9 percent to a high of 44.9 percent. By crop, the variance was even more pronounced--some crops were not insured at all, while others had over 60-percent participation in the program.

After determining the participation rates for the 10 states covered in our review, we contacted federal, state, and local crop insurance experts to obtain reasons for the low participation and suggestions for increasing it. Their responses, like the participation rates, also varied considerably.

Among the many reasons cited for low participation were (1) some farmers are unwilling or unable to bear the cost of crop insurance because of the poor condition of the farm economy; (2) many farmers believe that crop diversification is an adequate risk management tool; and (3) other federal programs provide farmers with direct cash payments at no cost, resulting in a perception that crop insurance is unnecessary. Among the suggestions cited for increasing participation were (1) change the rate structure by lowering the premiums to attract the higher-yield, lower-risk farmers; (2) increase the marketing and educational efforts to better inform the farmers of crop insurance; and (3) make crop insurance a condition for participating in other farm programs. In all cases, the responses we obtained represented the personal views of the individuals. They were not the result of any comprehensive study.

Since the expansion of the FCIC crop insurance program in 1980, no nationwide studies have been conducted to determine how or why reasons for low participation vary by geographic location. Studies conducted to date have been based on limited contacts with

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[1]Crop Insurance: Participation in and Costs Associated With the Federal Program (GAO/RCED-88-171BR, July 6, 1988).

[2]Alabama, Arizona, Delaware, Georgia, Maine, Maryland, Minnesota, North Dakota, Oklahoma, and Washington.

farmers and have covered limited numbers of crops and states. As a result, FCIC does not have a complete picture of the participation situation, nor does it know how best to structure a program to address it. We therefore believe that FCIC needs to comprehensively study the major factors influencing participation and the likely cost and effectiveness of various program and administrative changes intended to increase participation. Knowledge attained from such an effort would permit FCIC to implement marketing strategies in specific areas where they seem likely to be most effective. It would also prevent FCIC from implementing nationwide programs or strategies to address causes that may not need such broad-based attention.

For these reasons, we recommended in our July 1988 report that the Secretary of Agriculture require the Manager of FCIC to conduct a statistically sound, nationwide study to determine which of the major factors influencing participation could or should be addressed. To the extent that participation can be increased, the study should be designed to obtain information on the kinds of changes needed to achieve more participation and the costs of such changes to the government and farmers. Although costs are associated with any comprehensive study, we believe these costs could be minimized by focusing on areas of greatest need. In the long run, the results of the study could prevent FCIC from implementing expensive marketing strategies in areas where it can be demonstrated that there is little potential for increasing participation.

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