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Roles, Cost, and Criteria for Assessing Agriculture Disaster Assistance Programs Between 1980 and 1988

Statement of

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Subcommittee on Conservation, Credit, and Rural Development
House Committee on Agriculture
House of Representatives

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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the federal government's responses to natural disasters affecting American agriculture during the 1980s. Our testimony will address (1) the Department of Agriculture's (USDA) role in providing agricultural disaster assistance since 1980, including the cost of providing this assistance, and (2) criteria for assessing the federal role in providing disaster assistance to farmers and how well current programs meet these criteria. My statement today is based on a GAO report prepared at the request of Chairman de la Garza and yourself that has been released today.[1]

In summary, since 1980, USDA has provided disaster assistance to farmers through direct cash payments, emergency loans, and an insurance program. Between fiscal years 1980 and 1988, the federal government has incurred costs of approximately $17.6 billion in support of these programs: $6.9 billion for direct cash payments, $6.4 billion for disaster emergency loans, and $4.3 billion for crop insurance.

The principles we used in developing criteria for determining the best way to provide disaster assistance are based largely on the premises that disaster victims should be treated equitably and

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[1] Disaster Assistance: Crop Insurance Can Provide Assistance More Effectively Than Other Programs (GAO/RCED-89-211).

consistently over time and that overall program and society costs should be minimized. Our criteria are derived from various GAO analyses of disaster assistance that have been conducted over the past 13 years, from which we identified eight criteria that should be considered in devising an effective disaster assistance strategy. Although none of the three existing programs fully satisfy all of our criteria, crop insurance satisfies more of them than the other programs.

FEDERAL ROLE AND COSTS IN PROVIDING AGRICULTURE DISASTER ASSISTANCE BETWEEN 1980 AND 1988

Let me now briefly discuss the federal role and costs in providing agriculture disaster assistance since 1980.

Throughout the 1980s, USDA has provided disaster assistance to farmers through direct cash payments, subsidized loans, and subsidized insurance. Each of these programs helps farmers deal with a loss of income if their crops are damaged or destroyed by natural causes.

Before 1980, USDA provided disaster assistance mainly through direct cash payments and loans. New legislation was enacted in 1980 that greatly expanded the scope and availability of crop insurance.[2] At the time, the Congress believed that an expanded crop insurance program covering more crops and a larger part of the country would alleviate the need for expensive, ad-hoc disaster assistance programs.

However, despite the expanded scope and availability of crop insurance, the Congress has continued providing disaster assistance to farmers through direct payment and emergency loan programs during the 1980s. One reason for this is that crop insurance participation rates have remained relatively low. Since 1980, the amount of eligible acres enrolled in the program has risen from 9.6 percent in 1980 to 24.5 percent in 1988, well below the 50-percent target established for the program in 1980.

From 1980 through 1988, USDA spent approximately $17.6 billion to support the direct payment, emergency loan, and crop insurance programs. As indicated by chart 1, total costs for all three programs have increased every year since 1984. Chart 2 shows the costs for each of the three programs for fiscal years 1980 through 1988.

Direct payments have cost a total of $6.9 billion, reaching peaks of $1.4 billion in 1981 and $4 billion in 1988 as a result of especially severe droughts in those years. The costs for

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[2]The Federal Crop Insurance Act of 1980 (P.L. 96-365, Sept. 26, 1980).

administering the Disaster Assistance Act of 1988,[3] which includes 1989 outlays, are included in chart 2 under costs for fiscal year 1988.

USDA's emergency loan program costs were $6.4 billion from 1980 through 1988 and have been increasing steadily throughout the decade. Specifically, emergency loan program costs have risen from $245 million in 1980 to over $1.6 billion in 1988. Although most of the total costs have been due to interest subsidies, an increasing part of the rise in costs has been due to rapidly increasing loan defaults leading to debt write-offs.

The federal share of crop insurance costs since 1980 is about $4.3 billion. As was the case for other forms of disaster assistance, the federal costs for supporting crop insurance also increased during the decade. Total government contributions for the crop insurance program increased from $28 million in 1980 to $1.2 billion in 1988. Between 1985 and 1988 alone, the crop insurance program required a $1.8 billion infusion of new funds to pay indemnities owed to policyholders.

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[3]P.L.100-387, Aug. 11, 1988.

CRITERIA FOR ASSESSING CURRENT DISASTER ASSISTANCE PROGRAMS

Let me now briefly discuss our criteria for assessing federal disaster assistance programs to farmers and how well current programs meet these criteria.

In developing these criteria, we have taken the position that the policy principles of equity and efficiency are essential elements of any desirable disaster assistance program. These principles suggest that an equitable disaster assistance policy ensures that aid is provided consistently to victims suffering from similar losses over time. An efficient disaster assistance policy ensures that overall program and societal costs are minimized. Our work over the years has led us to identify the following eight criteria that should be considered in designing an equitable and efficient disaster assistance policy. These criteria are listed on charts 3 and 4.

Our first criterion is that the amount of disaster assistance provided should be determined by the amount of a farmer's loss, not by the severity of the disaster. Major changes in disaster assistance policy have often occurred in the wake of widespread natural disasters, like hurricanes or droughts. During these periods, direct payment and emergency loan assistance have been liberalized even though individual losses were less, in many cases, than those of an isolated disaster in which no compensation was available at all. Such ad-hoc approaches to disaster assistance policy, in which disaster relief programs or program terms are established after a major disaster has occurred, can result in different treatment for similarly affected disaster victims. In contrast, the terms of compensation under crop insurance are determined before a disaster occurs and therefore, crop insurance provides farmers equitable assistance more consistently.

Our second criterion is that disaster assistance programs should provide similar amounts of assistance to farmers suffering from similar amounts of losses. Although an equitable disaster assistance program would provide similar aid to victims suffering from similar losses, all three programs provide some disaster benefits indirectly through the tax code, primarily as deductions to income. Because the value of these deductions is higher for taxpayers in higher tax brackets than for taxpayers in lower tax brackets, similarly affected disaster victims may obtain different levels of total assistance from a given program if they are in different tax brackets. Because emergency loan recipients can deduct their entire disaster loss, and direct payment and insurance recipients cannot, tax benefits under the emergency loan program may be more substantial than under the other two programs.

Our third criterion is that disaster assistance programs should not provide farmers more assistance than the amount of their disaster losses. Farmers in all three programs may receive disaster assistance on the basis of county average production data, which can be higher than their actual production histories. Therefore, under some circumstances, farmers can be compensated for more than their losses under all three programs.

Criterion four is that disaster assistance programs should not create incentives to encourage farming practices that increase the likelihood and extent of losses. Subsidized disaster assistance programs discourage farmers from taking risk-reducing measures because, with subsidies, farmers may be able to obtain disaster assistance that provides nearly complete protection at a cost lower than prevention. Generally, the more a program is subsidized, the less likely it is that farmers will try to reduce risks. To the extent that all three programs are subsidized, they do not meet this criterion.

Criterion five is that disaster assistance programs should be consistently available over time to allow for long-range planning. Like other business managers, farmers must make decisions about risk and to what extent they want to protect their enterprise from events beyond their control. For example, the availability of direct payment and emergency loan programs has varied significantly over time, making it difficult for farmers to develop risk management plans. In contrast, once a crop insurance program has been established in a county, it has remained available for farmers in that county year after year.

Criterion six is that disaster assistance programs, in the way they provide financial assistance, should help farmers withstand and recover from the effects of natural disasters. Simply put, disaster assistance experience in the 1980s indicates that cash assistance, in the form of direct payments or insurance indemnity payments, helps farmers recover better from natural disasters than assistance in the form of loans. Loan programs do not provide farmers any of their expected income (unless the loan is forgiven) and increase farmers' debt burdens, which makes it difficult for some farmers to obtain financing for normal operations and recover from future disasters.

Criterion seven is that disaster assistance programs should have predictable annual costs. Costs could be made more predictable if the programs were managed on an actuarially sound basis, in which program costs are determined in anticipation of catastrophic events. Neither the direct assistance nor emergency loan programs have predictable costs. And although crop insurance was established to operate on an actuarially sound basis, crop insurance also does not have predictable costs because only about one-third of the current program is currently managed on an actuarially sound basis.

Our last criterion is that disaster assistance programs should meet their objectives at the lowest possible cost. As noted earlier, disaster assistance programs can meet their objectives at lower costs by incorporating incentives to reduce risky farm practices. However, subsidized disaster assistance programs discourage farmers from taking risk-reducing measures. Therefore, none of the three programs fully meet this criterion because all are subsidized.

In addition, offering farmers more than one form of disaster assistance, as in 1986 and 1988, causes USDA to spend more for disaster assistance than it probably would have if only one form of assistance were available to a farmer. For example, this occurs because ad-hoc direct payment programs have been designed to provide crop insurance policy holders additional benefits so they are not penalized for purchasing insurance.

CROP INSURANCE MEETS MORE CRITERIA THAN DIRECT PAYMENTS OR EMERGENCY LOANS

An analysis of how well each of the current programs satisfies our criteria shows that the crop insurance program satisfies three of these criteria, the disaster payments program satisfies one, and the emergency loan program satisfies none. (See app. I.) If some program characteristics were changed, these programs could satisfy seven, four, and four criteria, respectively. For example, the crop insurance program could have predictable annual costs if the entire program was run on an actuarially sound basis.

In concluding that crop insurance meets more of these criteria than other forms of assistance, however, we recognize that the crop insurance program has had a history of management problems that, in the short term, makes it difficult to justify the current crop insurance program as the sole source of disaster assistance to farmers. Consequently, if the Congress chooses to rely on the crop insurance program exclusively to provide crop disaster assistance, a transition period for strengthening the program probably would be necessary.

Another critical problem that the crop insurance program faces is that it has had to compete throughout the 1980s with direct assistance and loan programs, which have received larger amounts of federal funds and have had more attractive terms for farmers. Consequently, its participation rates have remained low, and it has never developed an actuarially sound program. We believe a restructuring of the agriculture disaster assistance programs that removes this disadvantage could help determine how effective the crop insurance system can be.

We also recognize that crop insurance is only appropriate for compensating victims who lost crops owing to a disaster. Other forms of assistance, including alternative insurance programs, would be more suitable for disaster-caused damages to farming and ranching infrastructure, such as the destruction of a barn, to help restore the productive capacity of a producer's enterprise.

Mr. Chairman, this concludes my prepared statement. My colleagues and I will be happy to answer any questions you may have.

Chart 1: Government Costs for Agriculture Disaster Assistance Programs (FY 1980-88)

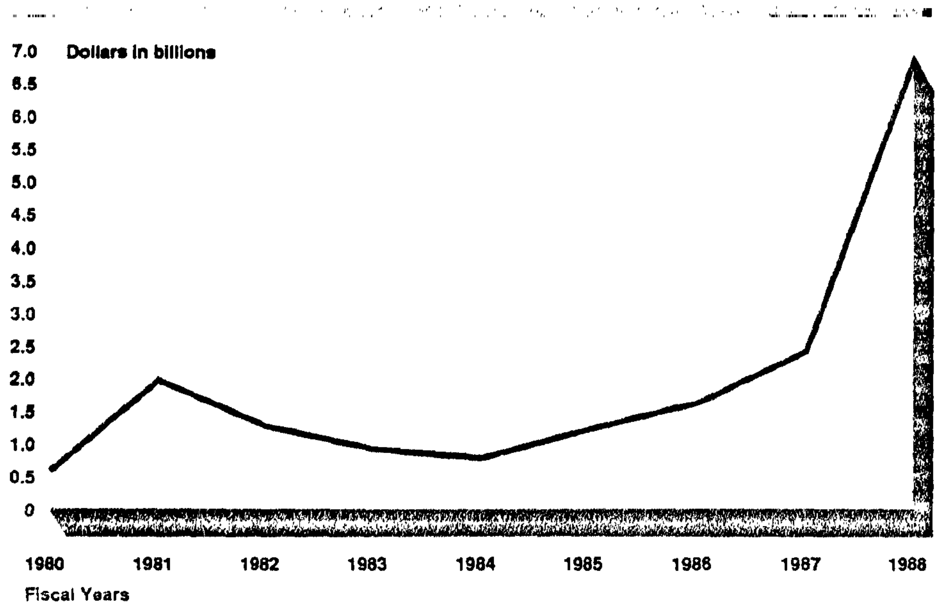
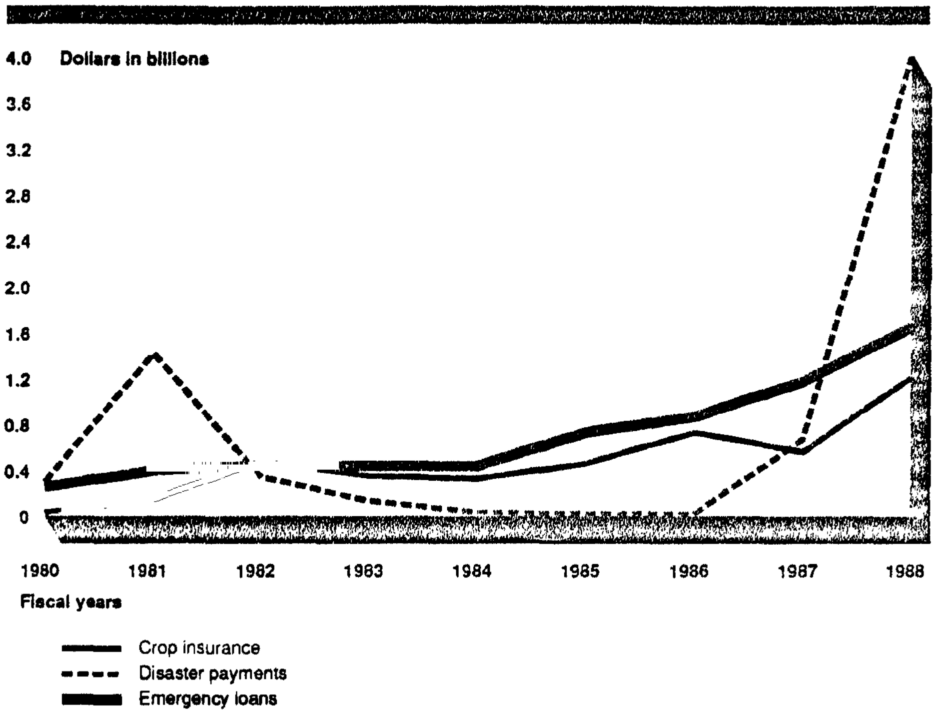


Chart represents actual government costs not adjusted for inflation.

Source: USDA

Chart 2: Government Costs for Direct Payment, Emergency Loan, and Crop Insurance Programs (FY 1980-88)



Totals for FY 1988 include disaster assistance payments made in FY 1989. Administrative costs for FY 1980 are not included.

Total emergency loan administrative costs for FY 1980-81 are not included. Administrative costs for those years only include money received from the revolving fund.

Source: USDA.

Chart 3: Disaster Assistance Criteria

1. The amount of disaster assistance provided should be determined by the amount of a farmer's loss, not by the severity of the disaster.

2. Disaster assistance programs should provide similar amounts of assistance to farmers suffering similar amounts of losses.

3. Disaster assistance programs should not provide farmers more assistance than the amount of their disaster losses.

4. Disaster assistance programs should not create incentives to encourage farming practices that increase the likelihood and extent of losses.

Chart 4: Disaster Assistance Criteria

5. Disaster assistance programs should be consistently available over time to allow for long-range planning.

6. Disaster assistance programs, in the way they provide financial assistance, should help farmers withstand and recover from the effects of natural disasters.

7. Disaster assistance programs should have predictable annual costs.

8. Disaster assistance programs should meet their objectives at the lowest possible cost.

CHART SHOWING HOW WELL DIFFERENT FORMS OF DISASTER ASSISTANCE MEET THE CRITERIA

	Criteria	Crop Insurance	Disaster Payments	Emergency Loans
1.	The amount of disaster assistance provided should be determined by the amount of a farmer's loss, not by the severity of the disaster.	Yes	No	No
2.	Disaster assistance programs should provide similar amounts of assistance to farmers suffering similar amounts of losses.	No	No	No
3.	Disaster assistance recipients should not provide farmers more assistance than the amount of their disaster losses.	Depends[a]	Depends[a]	Depends[a]
4.	Disaster assistance programs should not create incentives to encourage farming practices that increase the likelihood and extent of losses.	Depends[b]	Depends[c]	Depends[b]

[a]Would meet criterion if actual production histories were used exclusively.

[b]Would meet criterion to the extent that programs were not subsidized. For crop insurance, incentives would be reduced to the extent that premiums reflected actual risks and that subsidization of high-risk participants by low-risk participants was minimized.

[c]Would meet criterion to the extent that losses are only partially compensated and that compensation for risky farming practices was prohibited.

	Criteria	Crop Insurance	Disaster Payments	Emergency Loans
5.	Disaster assistance programs should be consistently available over time to allow for long-range planning.	Yes	No[a]	No
6.	Disaster assistance programs, in the way they provide financial assistance, should help farmers withstand and recover from the effects of natural disasters.	Yes	Yes	Depends[b]
7.	Disaster assistance programs should have predictable annual costs.	Depends[c]	No	No
8.	Disaster assistance programs should meet their objectives at the lowest possible cost.	Depends[d]	Depends[e]	Depends[d]

[a]The Emergency Feed Program and the Emergency Feed Assistance Program are consistently available to producers to help them with long-range planning.

[b]Meets criterion only to the extent that loan principal is forgiven.

[c]Meets criterion to the extent that the program is run on an actuarially sound basis.

[d]Would meet criterion to the extent that programs were not subsidized. For crop insurance, incentives would be reduced to the extent that premiums reflected actual risks and that subsidization of high-risk participants by low-risk participants was minimized.

[e]Would meet criterion to the extent that losses are only partially compensated and that compensation for risky farming practices was prohibited.