policy pennings

∆ **Contact Dr. Daryll E. Ray or Dr. Harwood D. Schaffer**
at the UT's Agricultural Policy Analysis Center by calling
(865) 974-7407,faxing (865) 974-7298,
or emailing dray@utk.edu or hdschaffer@utk.edu
For more info, visit: www.agpolicy.org

Purely Privatized Crop Insurance Program: What Does That Mean?

DR. DARYLL E. RAY
Agricultural Economist
University of Tennessee

DR. HARWOOD D. SCHAFFER
Research Assistant Professor at APAC, University of Tennessee

As talk at the elevator and at various farm organization meetings turn to a discussion of the 2012 Farm Bill, one of the questions relates to which programs are likely to make it into the new bill and which are vulnerable. The answer as to the vulnerability of various programs depends upon who is talking and what part of the country they live in. The list of programs under discussion are fairly constant: crop/revenue insurance, direct payments, ACRE, the marketing loan program, and the counter-cyclical payment program.

The marketing loan program – including loan deficiency payments and marketing loan gains – and the counter-cyclical payment program may remain in the legislation out of inertia. But, they are seen to be largely ineffective because the trigger levels for both are now well below the cost of production and prices are significantly above levels where payments would be made.

Despite the hoopla surrounding the ACRE program, for whatever reason the sign-up levels have been well below expectations. Even among corn growers where the support was the greatest during the last farm bill debate, sign-ups have been weak.

Direct payments are under fire because they are paid whether prices are high or low. They received a significant amount of attention during 2008 when crop prices and farm incomes were at record levels and the payments added to already robust profits.

That brings us to crop insurance. In our discussions with people around the country, the idea of questioning crop/revenue insurance is akin to questioning apple pie and motherhood. In the recent legislation on reigning in the subsidies paid to crop insurance companies, they flexed their muscles.

We have read about calls to fund a "purely privatized crop-insurance program" by eliminating direct payments. Notice the obvious disconnect that calls for shoveling government money into a "purely privatized crop-insurance program," how can it be purely private if it depends on the government dole?

In our minds a purely privatized insurance program would be one that operates solely on the premiums paid by its customers. The rates charged would be dependent upon the level of risk being insured plus a margin of profit that would allow the company to operate.

For many years township mutuals and other farm organizations offered a variety of insurance products to indemnify the policyholder against covered perils – like wind, and fire – for named items like houses, barns, and other outbuildings. In addition they often covered automobiles and farm machinery. Depending upon the area and the crop, there were also policies that would cover producers against a loss due to hail.

That is what a purely privatized insurance program looks like and it worked well for many years. You had a private insurance program to cover risks that were calculable, affordable, and generally random in their occurrence.

At the same time you had a farm program that worked to protect farmers against long periods of low prices – a risk that would be too expensive for private insurance companies to cover. In addition Congress often voted for ad hoc disaster aid to provide aid to farmers who were struck by widespread problems like drought and storms. Again this was a risk that private insurance companies shied away from because of the risk of massive payouts in a single year.

Over time, those opposed to government-run farm programs began to see farm insurance companies as a market-based mechanism that could be used to protect farmers against both the variations in price (the function of traditional farm programs) and production (ad hoc disaster aid). The only problem with such a program is that the premiums would be higher than farmers would be willing to pay.

Enter the government and massive subsidies. In the end, we have ended up privatizing the gains – insurance companies, reinsurance companies, insurance agents and their agencies, and advertisers did well – and socializing the risks. The government provided excess coverage, limiting the risk to the companies.

Now those who want to protect the amount of money that the direct payments represent, have suggested rolling at least a major portion of those payments into an improved crop insurance program. The idea is that income would be covered at a much higher level than before.

Over the next ten years, the present crop/revenue insurance program is projected to cost $6 billion a year above the payments paid by farmers. If direct payments are rolled into the program to provide higher levels of coverage that could add as much as $5 billion a year – $11 billion a year in federal outlays.

An $11 billion-a-year-subsidized program, part of which flows into the coffers of insurance companies, hardly sounds like a "privatized" system.

The question is: could that money be better used in a different program configuration and still stabilize farm income with most of the farm revenue coming from the marketplace? ∆

DR. DARYLL E. RAY: Blasingame Chair of Excellence in Agricultural Policy, Institute of Agriculture, University of Tennessee

DR. HARWOOD D. SCHAFFER: Research Assistant Professor at APAC, University of Tennessee