

Risk Management and the Farm Bill: The Role of Crop Insurance

Hyunok Lee and Daniel A. Sumner

Risk management subsidies, of which federal crop insurance is a large component, have an expanding role in federal farm programs and are of growing importance for California specialty crops.



The participation rate for buy-up insurance for wine grapes, which is the highest revenue crop in California, is about 40%, whereas buy-up insurance covers less than 20% of table grape acreage.

Despite all the dispute and delay over the farm bill, both the Senate and House have agreed that the focus of renewed and revised farm commodity policy would be on “risk management.” Indeed, the House-passed farm bill is officially the “Federal Agriculture Reform and Risk Management Act.”

Both the House and Senate versions of the farm bill include payments to grain and oilseed producers when area-wide crop revenue falls below specified triggers. These “shallow-loss” programs have been designed to supplement individual farm poli-

cies for revenue insurance available at highly subsidized premiums for these program crops. For cotton, a new, heavily subsidized area-wide revenue insurance program (STAX) is designed to stack on top of individual revenue insurance policies. And, as an accompanying article explains, a new margin insurance program replaces traditional price support programs for dairy.

Although offered by private companies, federal crop insurance is highly regulated and subsidized. Farmers pay less than 40% of the premiums on average, and the federal government covers the administration and operation costs of the insurance companies and offers “reinsurance,” which covers company losses. All these features would remain in place under all the farm bill options currently being discussed.

Fruit, tree nut, and vegetable crops have never been eligible for the traditional commodity programs that have provided billions of dollars in payments and price supports for grains, oilseeds, and cotton since the New Deal. In addition, for many years subsidized crop insurance was not available or not attractive for most California specialty crops. However, over the past decade, farmers have taken advantage of an increase in crop insurance availability and attractiveness for these crops that are so important in California agriculture. By 2011 subsidized crop insurance was available for more than 80 specialty crops. Although many vegetable crops as well as many small-revenue crops or locations are not covered, total liabilities for specialty crops reached nearly \$12 billion in 2011—nearly 10% of total crop insurance liabilities in the nation.

The current farm bill debate accepts and reinforces the expanding role of federally subsidized crop insurance, while broadening the risk management

rationale for farm subsidies. This article documents the increasing importance of crop insurance for California crops in the context of the farm bill debate.

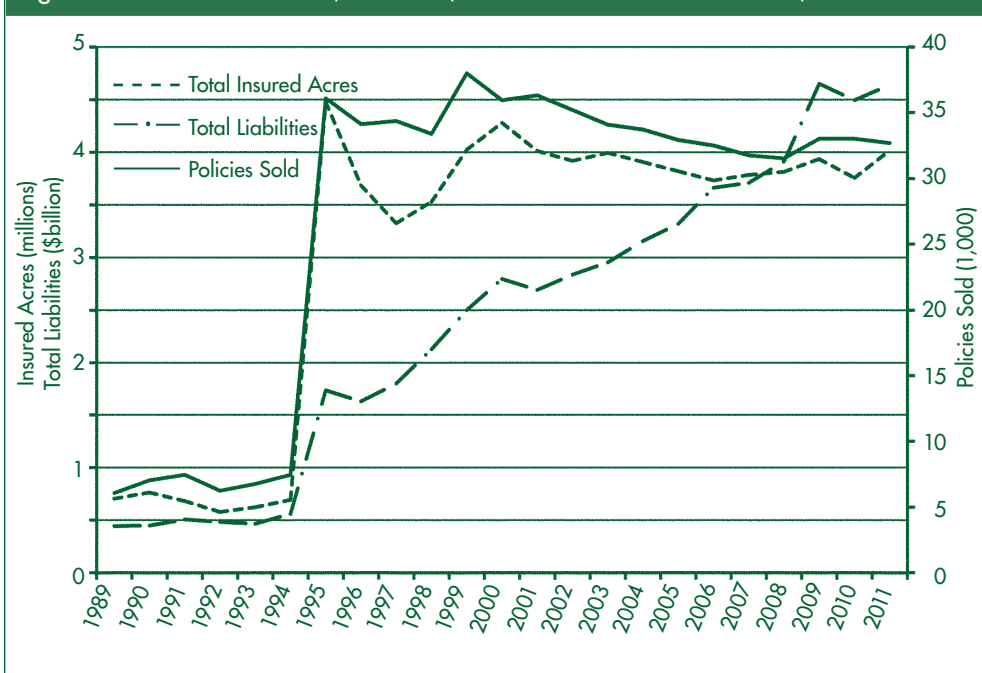
Crop Insurance for Specialty Crops

Based on the definition in the Specialty Crops Competitiveness Act of 2004 (SCCA), “specialty crops” include fruits and vegetables, tree nuts, dried fruits, horticulture and nursery crops (including floriculture). Federal crop insurance for these crops remained limited until passage of the Federal Crop Insurance Act of 1980. Expansion continued over the subsequent decades. By 2011, insurance was available for most perennial fruit and nut crops, dry and fresh beans and peas, fresh market and processing tomatoes, mustard, peppers, potatoes, pumpkins, sweet potatoes, and some nursery crops. Given that specialty crops account for about one-third of crop revenue nationally, the 10% of total crop insurance liability accounted for by specialty crops remains a significant under-representation.

In general, a host of insurance products are offered, including insurance covering shortfalls in yield, revenue, or some other index. With the exception of nursery crops, yield insurance based on actual production history (APH) is most widely available and used for specialty crops, while revenue insurance is more important for field crops.

Federal crop insurance provides two broad types of insurance plans: catastrophic and buy-up. The catastrophic plan (CAT) insures eligible farms for a 50% of yield loss at 55% of the USDA-announced price and charges only a small processing fee. This catastrophic insurance thus returns a maximum of about 27.5% of “expected” revenue, but costs growers little. Growers can also “buy-up” additional coverage up to 85%

Figure 1. Total Insured Acres, Liabilities, and Policies Sold in California, 1989–2011



of production per acre with value up to 100% of a USDA-announced price that is based on a specified market price established for each crop and region.

Status of Crop Insurance in California

The purchase of federal crop insurance by California farmers has increased rapidly since 1989 (Figure 1). The big jump in acreage, policies sold and, to a lesser extent, liabilities occurred in

1995 when the CAT insurance option became available. Total policies sold have gradually declined from about 35,000 to about 33,000 since 1995, while total acres have declined from a high of about 4.5 million acres in 1995 to about 4 million acres in 2011. Liabilities have grown steadily from about \$1.7 billion in 1995 to more than \$4.5 billion in 2011—an almost tripling of crop insurance liabilities.

When it was introduced in 1995, the CAT option accounted for about \$1 billion of liabilities, while the buy-up insurance option accounted for about \$0.7 billion (Figure 2). CAT liabilities grew until 2008, but buy-up grew faster. Since 2008, CAT liabilities have declined while buy-up liabilities have jumped. In 2011 the share of buy-up liabilities exceeded two-thirds of total liabilities. Overall, the share of acreage covered under buy-up increased for all crops even as total acreage continued to expand for many specialty crops.

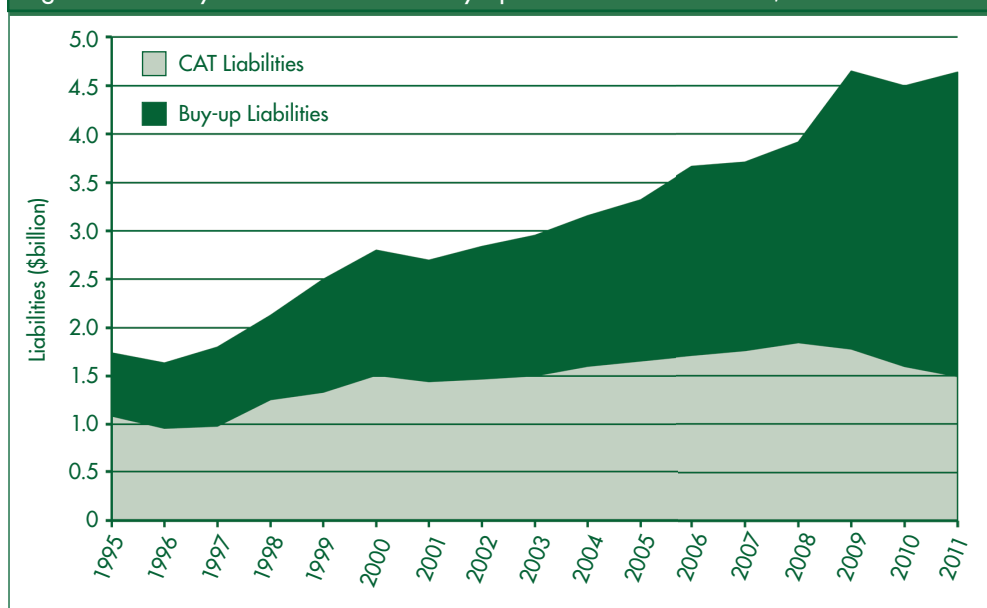
Moreover, given the importance of specialty crops in California, APH accounts for the majority of crop insurance in California. In 2011 APH accounted for over 70% of total liability in California. Where grains and oilseeds are dominant, revenue insurance is much more important to the liability profile.

Crop insurance participation in California differs widely across specialty crops (Figure 3). Based on buy-up data (since CAT sign-ups are almost free for participants), crop insurance participation measured as the share of acreage was highest for processed tomatoes, cherries, and prunes—with about 80% shares.

In 2012 coverage of buy-up insurance was lowest for onions, which had less than 10% of acreage covered. Avocados and walnuts both had less than 15% of acreage covered with buy-up insurance. Onion plantings have no CAT coverage listed, while more than half of the acreage of avocados and walnuts is covered if the minimal CAT coverage is included.

The participation rate for buy-up insurance for wine grapes, which is the highest revenue crop in California, is about 40%, whereas buy-up insurance covers less than 20% of table grape acreage. There is wide divergence among the tree nuts. Only about 14% of walnut acreage was covered

Figure 2. Liability Shares of CAT and Buy-up Insurance in California, 1995–2011



by buy-up insurance and another 40% with CAT. In contrast, about 40% of almond acreage is covered by buy-up insurance and another 50% by CAT.

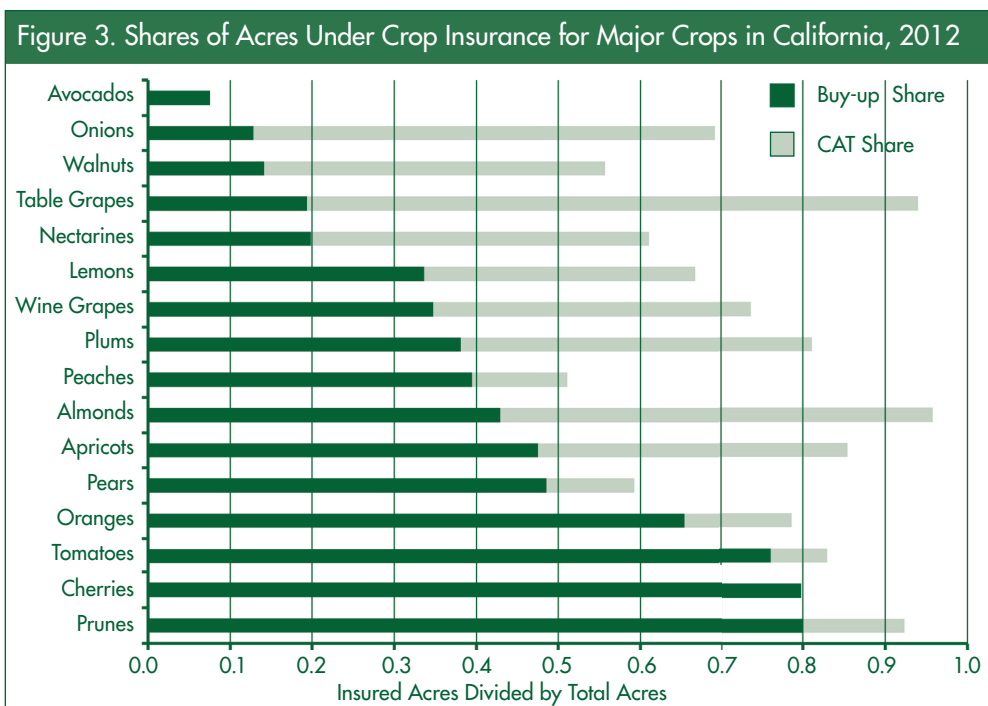
Crop Insurance and Risk Management in the Farm Bills Under Discussion

Both the House and Senate versions of the farm bill include several crop insurance revisions that could be important for specialty crops.

The bills mandate expanded coverage for “underserved” crops and regions, and this effort is extended to more specialty crops and regions:

- A premium discount of 10% will be offered for beginning farmers and ranchers;
- Index-based weather insurance is expanded (but this is less likely to be useful for California producers);
- Additional studies are mandated for insuring specialty crop producers for food safety and contamination-related losses; and,
- Proposals for insurance against losses from disruptions due to invasive species are under consideration.

In general, the proposed farm bills (in both the House and Senate versions) attempt to convert income support programs into risk management policies, including crop insurance. Several drivers account for this transition. First, as payments under other support programs recede to near zero, primarily because prices for program crops have been high by historical standards, crop insurance has become a major source of farm subsidies and transfers from taxpayers to farm operations. Second, whereas other payments face limits on the size of payments and on the eligibility for payments based on farmer income, such restrictions do not apply generally to crop insurance benefits. Third, insurance companies and local crop insurance agents are major beneficiaries of subsidized crop



insurance. They have emerged as strong advocates of maintaining and expanding the federal crop insurance programs.

Concluding Considerations

The new farm bill, whichever version is accepted and whenever it actually passes, will almost surely place more emphasis on risk management as a rationale for farm subsidy. Crop insurance has become a central piece of government policy for commodities and has the largest share of the commodity support budget. Federal costs for crop insurance outlays exceeded \$12 billion in 2012, compared to about half that for other crop subsidies.

While California specialty crops remain under-represented in this budget, they receive a much larger share of federal attention under crop insurance than the negligible part they played in the traditional price and income programs. As the programs grow in importance, evaluating the implications of crop insurance for the long-term health and prosperity of California agriculture is worthy of much more research.

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Hyunok Lee is a research economist and Daniel Sumner is the Frank H. Buck, Jr. Professor, both in the Department of Agricultural and Resource Economics at University of California, Davis. They can be contacted by email at hyunok@primal.ucdavis.edu and dasummer@ucdavis.edu, respectively.

For additional information, the authors recommend:

- Lee, Hyunok, and Daniel A. Sumner. “What is the Role of Crop Insurance for ‘Specialty’ Crops?” *OreCal Issues Brief* 006, 2013. http://orecal.org/storage/issues-briefs/OreCal_Issues_Brief_006.pdf
- Sumner, Daniel A., and Carl Zulauf, Ohio State University. 2012. “Economic and Environmental Effects of Agricultural Insurance Programs.” C-FARE <http://issuu.com/c-fare/docs/econenveffectsofaginsurance>