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CONSERVATION COMPLIANCE: The Obscure Environmental Provision Key to Protecting Taxpayers and Privatizing Crop Insurance

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THE OVERWHELMING MAJORITY of American farms receive federal subsidies of some sort. These payments are controversial and, in the opinion of many who favor smaller government, ought not to exist at all. This paper discusses some of the subsidies and argues that ongoing efforts to change crop insurance programs should maintain and expand “conservation compliance” policies in order to aid future efforts to privatize the system.

As of late 2012, agricultural subsidies provided directly to farmers include direct payments that are made whether or not crops are grown; heavily subsidized crop insurance; dozens of loan programs; and at least ten other programs that provide farmers with cash or tax credits in return for doing (or not doing) certain things.¹ A bevy of nutritional

1. See e.g. Environmental Working Group. “Farm Subsidy Payments by Category,” <http://farm.ewg.org/region.php?fips=00000>

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subsidies, most importantly the Supplemental Nutrition Assistance Program, still widely known by its former name of “food stamps,” also provide indirect support that is hugely important to agricultural markets and farmers themselves.

As Congress works to renew the current Farm Bill—statutory authorization expired on Sept. 30, 2012, although some programs have been extended until Dec. 31—at least some calls for reform appear to have been heeded. One significant program, Direct Payments, appears very unlikely to survive any significant reauthorization. Bills passed by both Senate and House committees, as well as the Senate as a whole, have ended Direct Payments.² Currently, Direct Payments are tied to “conservation compliance,” a policy that provides subsidies only if farmers work to conserve soil, avoid destroying wetlands and otherwise do things considered to be in the public interest.

This paper provides a brief outline of a free-market, limited-government attitude toward farm subsidies, reviews the direction of the current legislation, and, finally, makes the case for re-attaching to crop insurance programs the conservation compliance requirements currently associated with Direct Payments. The paper argues that, while the elimination of *all* supplier side farm subsidies would be the ideal situation, retaining conservation compliance requirements as part of any farm subsidy program—and particularly crop insurance—ought to be considered an important step toward a free market farm policy. In particular, it argues that conservation compliance programs are sensible on their own terms, could potentially help set the stage for the eventual privatization of existing programs, and ought to be expanded.

A FREE MARKET APPROACH TO AGRICULTURE SUBSIDIES AND CROP INSURANCE

THE BUSINESS OF growing food and fiber is not special. Farmers certainly face uncertainties related to weather and

2. Officially the Direct Payments Program is actually a collection of three different programs oriented towards different functions. See e.g.

market prices, but so do a huge number of other industries, from shipping to tourism to insurance and financial services to oil and other commodities. If there were ever a need to ensure the existence of farmers in every region or guarantee particular farms to stay in business, it has long passed. Most food today is produced on large-scale farms and most new farms are essentially hobby operations that produce less than \$20,000 in annual revenue.³

Ideally, farmers should look to government to enforce the law, uphold private contracts, build certain core infrastruc-

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ture, provide social services available to everyone, and fund basic scientific research on topics related to agriculture but, otherwise, leave them alone. In short, all or almost all direct and indirect supplier-side subsidies to agriculture should end.⁴ As such, any program that is tied to subsidies (as conservation compliance is) should be considered a “second best” outcome relative to the end of subsidy programs altogether.

While ending all farm subsidy programs entirely would present the best possible public policy outcome, such a scenario seems hugely unlikely. Even the so-called “Ryan Budget” passed this year by House Republicans, derided by many liberals as too austere, leaves many farm subsidy programs in place. Indeed, no bill to end all farm subsidies has even been proposed in the current Congress. As such, the position that farm subsidies ought not to exist is not a realistic one. Farm subsidies, in some form, will continue and those intent on getting rid of them should work to set the stage (which is what R Street believes should happen) for phasing them out over time.

3. Bureau of the Census. “Table 823. Selected Characteristics of Farms by North American Industry Classification System (NAICS): 2007”

4. For a case on this see e.g. Chris Edwards, “Agricultural Subsidies,” *Cato Institute*, June 2009, <http://www.downsizinggovernment.org/agriculture/subsidies>.

The Farm Bills currently under serious consideration in both the House and Senate eliminate direct payments and replace them with a set of new programs known colloquially as “shallow loss.”⁵ Like existing crop insurance, the proposed programs would protect crops against natural disasters and changes in market prices that reduce revenue. Unlike existing subsidized coverage, which requires farmers to assume as much as half of the risk themselves, shallow loss programs will guarantee that farmers lock-in up to 90 percent of the revenues they’ve been earning during the recent period of record high commodity prices. (Current proposals for shallow loss would offer the coverage with no contribution by the farmers themselves, although this could potentially change.)

Whatever eventually emerges from Congress appears highly likely to rely upon the basic structure of subsidized crop insurance to serve as the primary form of government largess granted to farmers. Thus, for those seeking to limit the government’s role in subsidizing agriculture, the specific structure of such programs becomes highly relevant.

CONSERVATION COMPLIANCE: HOW IT WORKS AND WHAT BENEFITS IT BRINGS

SINCE 1985, A group of eligibility requirements called “conservation compliance” have been attached to a variety of agricultural subsidies. The U.S. Department of Agriculture sets out four major objectives for conservation compliance:

1. reduce soil erosion on the nation’s cropland;
2. protect the nation’s long-term capability to produce food and fiber;
3. reduce sedimentation and improve water quality; and
4. preserve and protect the nation’s wetlands.⁶

Conservation Compliance consists of two basic components: wetlands conservation (popularly known as Swampbuster) and Highly Erodible Land provisions (popularly known as Sodbuster.) A third concept, “Sodsaver”—intended to prevent natural grassland areas from being farmed—has also been proposed and was included in the Senate-passed Farm

5. Vincent H. Smith et al. “Shallow Loss: A New, Costly Giveaway to Farmers?” American Enterprise Institute, May 30, 2012, <http://www.aei.org/press/economics/fiscal-policy/shallow-loss-a-new-costly-giveaway-to-farmers-release/>

6. United States Department of Agriculture. “Highly Erodible Land and Wetland Conservation Compliance Provisions,” http://www.usda.gov/documents/HIGHLY_ERODIBLE_LAND_AND_WETLAND_CONSERVATION_COMPLIANCE.pdf

Bill.⁷ Swampbuster denies subsidies for farming land that, because of its location or soil type is particularly likely to erode, unless a conservation plan is put in place to control erosion.

The USDA's Natural Resources Conservation Service is responsible for helping farmers determine what areas are impacted. Under Swampbuster, farmers are made aware they will not receive subsidies for farming any lands converted to agricultural purposes since 1985 that were designated.⁸ Wetlands are areas where water saturation is the "dominant factor in determining the soil structure and types of plant and animal life present."⁹ Most wetlands are physically wet for at least six months a year. There are provisions that allow for "minimal effects" to wetlands and "mitigation" or building a new wetland if a farmer needs to remove a problematic wetland area that provide flexibility to meet farmer needs.

Sodbuster regulations are much more complicated. Farmers must maintain soil conservation plans for highly erodible land that is both currently, and was prior to 1985, in active crop production. When farmers want to prepare highly erodible lands that are not currently producing crops, Sodbuster requires before they put that land into production that they first implement erosion-limiting plans based on soil tolerance levels.

Though only a small percentage of farms are ever audited to make sure they comply with Sodbuster and Swampbuster regulations, mapping and oversight do consume some resources. Nonetheless, conservation compliance programs have, on balance, provided at least \$1 billion of savings since 1985 by proscribing agricultural subsidies that otherwise would have been granted.¹⁰ Additional savings also are realized by preventing soil erosion, thus avoiding costly dredging and water treatment, and from preserving the natural buffers that wetlands provide, thus cutting down on expensive flooding and water pollution.

Currently, 13 programs have conservation compliance tie-ins of various kinds, although only one of these, the Direct Payments Program has very large-scale participation. Roughly 1.6 million of the nation's 2 million farms participate in

Direct Payments,¹¹ with livestock operations and very small farms -- and some large farms whose adjusted gross income is too high to meet eligibility for farm supports -- constituting most of those that do not. Although there would still be some conservation compliance language left in statute were Direct Payments to be eliminated, the programs would no longer apply to most farmers under the new crop insurance scheme through which most subsidies will likely be granted in the future. Without conservation compliance, taxpayers could be on the hook for subsidies to farms converted from wetlands and erodible land.

One way to change this would be to return the link between conservation compliance and crop insurance that existed between 1984 and 1996 before being abolished as part of the 1996 Freedom to Farm bill, which also created the modern Direct Payments Program.¹² The rest of the paper argues for restoring this link.

CONSERVATION COMPLIANCE IS A GOOD IDEA ON ITS OWN TERMS

CONSERVATION COMPLIANCE IS sound environmental policy. Since their introduction in the 1930s, agricultural supports have included various provisions to prevent soil erosion and destruction of otherwise good land. These have taken the form of efforts to encourage farmers to set "soil building goals," starting in the 1930s and a "soil bank" in the 1950s.¹³ Since the early 1980s, however, the primary method of discouraging erosion has been denying payments and program participation to farmers who use highly erodible land or wetlands as the Natural Resources Conservation Service defines them.

These programs accomplish their intended purposes. Although a number of factors have contributed to an impressive overall decline in soil erosion and a slowing rate of wetlands loss, the best estimates show that about 25 percent of the reduction in soil erosion can be attributed to conservation compliance.¹⁴ Similarly positive results can be found from the Swampbuster program.¹⁵ Those conservation

7. See e.g. Ducks Unlimited. "Sodsaver: Saving America's Prairies," <http://www.ducks.org/conservation/farm-bill/sodsaver-saving-americas-prairies?poe=farmBill>

8. See e.g. National Agricultural Law Center. USDA Compliance: Sodbuster and Swampbuster, <http://www.nationalaglawcenter.org/assets/farmbills/conservation.html>

9. Environmental Protection Agency. "Wetlands Definition," <http://water.epa.gov/lawsregs/guidance/wetlands/definitions.cfm>

10. See e.g. United States Department of Agriculture. "Conservation Compliance and Sodbuster," <http://www.ers.usda.gov/media/871561/arei6-3.pdf>

11. Lisa Shames. "Direct payments Should be Reconsidered," Government Accountability Office, July 3, 2012, <http://www.gao.gov/products/GAO-12-640>

12. Otto Doering and Katherine Smith. "Examining the Relationship of Conservation Compliance and Farm Program Incentives," Council on Food, Agriculture and Resource Economics, July, 2012, <http://issuu.com/c-fare/docs/conservationcomplianceandfarmprogramincentives>

13. *ibid.*

14. Roger Classen. "Have Conservation Compliance Incentives Reduced Soil Erosion?" in *Amber Waves*, June, 2004, <http://webarchives.cdlib.org/sw1vh5dg3r/http://ers.usda.gov/AmberWaves/June04/Features/Have-Conservation.htm>

15. Robert Classen et al. *Estimating the Effects of Relaxing Agricultural Land Use Restrictions: Wetland Delineation in the Swampbuster Program. In Review of Agricultural Economics*. 20(Fall/Winter 1998):390-405.

compliance practices that result in higher short-term profits may have been adopted even absent the program,¹⁶ but the additional benefits of retaining wetlands in reducing flood losses and removing pollutants from surface water endures.

In addition to accomplishing their desired purpose, conservation compliance incentives are simply smart policy. While the programs certainly have costs for taxpayers, they achieve obvious public purposes for very minimal outlays from the Treasury.¹⁷ For farmers, there are no real costs. If farmers do not want to access the subsidies, they do not have to participate. The programs, furthermore, are entirely voluntary. Farmers who do not like the conservation compliance incen-

“In addition to accomplishing their desired purpose, conservation compliance incentives are simply smart policy.”

tives, they can simply farm as they please without public support of any kind. Insofar as taxpayers provide any assistance to farmers, it makes sense to make the assistance contingent on taking actions in the public interest.

This idea of attaching strings to subsidies has long been a theme of conservative policy in many areas. The hugely successful 1996 Work Opportunity and Personal Responsibility Act, for example, tied cash assistance welfare to work and other socially activities. Proposals to impose work requirements on SNAP recipients are likewise popular on the political right.

Indeed, a direct analogy to conservation compliance already exists in the environmental policy realm. Under the Coastal Barrier Resources Act,¹⁸ a law signed and strongly supported by President Ronald Reagan, the federal government withdrew nearly all subsidies for development in certain areas of environmentally sensitive coastal barrier islands and barrier beaches. That law, like conservation compliance, has been a significant success. It has saved more than \$1 billion in tax-

payer resources and, collectively, the area of land preserved by the law is larger than all but one National Park in the lower 48 states.¹⁹

RESTORING THE TIE BETWEEN CONSERVATION COMPLIANCE AND CROP INSURANCE WILL MAKE IT POSSIBLE TO PRIVATIZE THE PROGRAM

AS INSURANCE PROGRAMS —or, at least, those that take the form of insurance—become the dominant form of agricultural subsidy, conservation compliance is likely to become even more important. If heavily subsidized crop insurance (including a shallow loss program that collects no premium payments) becomes the norm, it will create enormous moral hazard. In particular, farmers will have huge incentives to begin planting in areas where crops are likely to be lost. Once the combination of insurance and government grants cover as much as 90 percent of a farmer’s losses (as they would under some proposed versions of the shallow loss), farmers that see even a 10 percent chance of getting yields out of a certain area of land would still, in the long run, break even by planting there.²⁰ This would encourage the wholesale transformation of very marginal areas and result in farmers building their business models around the idea of receiving government indemnities, rather than sound land and resource management.

In addition, private companies simply could not write this type of insurance. Insurance is written in anticipation of a potential loss. In order to make a profit, insurers must set aggregate premiums for a particular kind of risk as high, or nearly as high, as the expected losses themselves. When it comes to providing “insurance” on marginal lands, where losses are both very likely and highly correlated with the losses suffered by other farms, such premiums are likely to be too high for farms to pay.

When many farmers buy heavily subsidized insurance, and make land and capital investments contingent on the existence of such products, it may well become politically impossible to move crop insurance towards the private sector. This is, indeed, exactly what has happened to the National Flood Insurance Program. Because flood insurance has provided so many incentives for development in river valleys and near the coast, there exists a very large constituency that favors continued subsidies.²¹ This made major reform very difficult

19. Ibid.

20. In reality, it’s highly likely that farmers would need a greater than 10 percent chance of successfully harvesting a crop before planting. But land on which crops were more likely than not to be lost would still almost certainly be planted.

21. Eli Lehrer. *Watery Marauders: How the Federal Government Obstructed The Development of Private Flood Insurance*, The Independent Institute, October, 2009. http://www.independent.org/pdf/policy_reports/2009-10-19-watery.pdf

16. Ibid.

17. Doering and Smith, *supra*.

18. Fish and Wildlife Service. “Coastal Barrier Resources Act,” <http://www.fws.gov/CBRA/>

and resulted in a reform bill that, at best, moved the nation only part-way towards privatization.²²

Conservation compliance, as it happens, mimics the underwriting and rating processes that private insurers use when deciding whether to issue policies, and in pricing them after they have been issued. Although it's not a market mechanism itself, it mimics one in an effective fashion. While a link between crop insurance and conservation compliance will not, by itself, result in the privatization of crop insurance, it is difficult to think how the program could ever be transitioned to the private sector unless a very large part of its book of business is essentially similar to coverage that the private sector would write.

Linking conservation compliance to crop insurance, in short, will reduce the moral hazard the insurance program creates and set the stage for privatization. Expanding conservation compliance efforts by implementing Sodsaver and other restrictions that might be proposed in the future, likewise, would almost certainly serve to make the program smaller, less likely to create moral hazard, and easier to privatize.

CONCLUSIONS

AMERICAN FARMERS RECEIVE significant and costly agricultural subsidies that, in the opinion of many who favor free markets, ought not exist. Some of these subsidies long have been tied to behaving in certain ways and, since the mid-1980s, they have been linked to conservation compliance" programs that reduce or eliminate government assistance for farmers who farm wetlands and highly erodible land without a good conservation plan. Academic research shows these programs are good ideas on their own terms. Continuing them and, in particular, linking them to crop insurance will protect the environment, save money for taxpayers, and make it easier to phase out agricultural subsidies in the future. Efforts to link crop insurance to conservation compliance deserve serious consideration from Congress.

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22. Independent Insurance Agents and Brokers of America. "The Biggert-Waters Flood Insurance Reform and Modernization Act of 2012," <http://www.iiaba.net/webfolder/na/jeff/big%20i%20firm%20summary.pdf>