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## CAPPING PREMIUM SUBSIDIES WON'T KILL CROP INSURANCE

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### INTRODUCTION

The federal crop insurance program, administered by the U.S. Department of Agriculture's (USDA) Risk Management Agency (RMA), serves as the largest single source of federal support for farms nationwide. Created during the Great Depression as a safety net to protect farmers from extreme loss due to market volatility and natural disasters, the program has been augmented several times via legislation, particularly the establishment of the RMA in the 1990s.

The program again expanded dramatically with passage of the Agriculture Act of 2014, as policymakers sought to replace the politically unpopular direct-payment system with what they anticipated would be a more market-friendly risk-management approach. In the past few decades, federally supported crop insurance has evolved into a massive, ever-expanding program that now covers about 130 crops and nearly 300 million acres of land.<sup>1</sup> The USDA subsidizes an average of 62 percent of participating agricultural

producers' crop-insurance premiums, regardless of the size of their operations. With no reasonable controls on the program's growth, farmers are encouraged to buy more insurance than they need, while taxpayers are forced to bear much of the risk. The majority of federal support flows to major agribusinesses, rather than small farms struggling to stay afloat.

In an attempt to rein in the ballooning federal program and eliminate its tendency toward cronyism, reformers in recent years have proposed enacting payment limits that would cap the amount any individual farmer could receive in annual premium subsidies. For example, a measure proposed by Reps. Ron Kind, D-Wis., and Tom Petri, R-Wis., during the last farm-bill negotiations would have capped payments at \$50,000 and mandated means-testing for premium support, such that farms netting more than \$250,000 could not receive any subsidies. This amendment failed by a narrow margin, but the reaction from the farm lobby and politicians with agricultural constituencies was typical. Any attempt to limit premium subsidies—no matter how modest—tends to be met with vigorous opposition from farm-subsidy supporters, who claim without evidence that such caps would devastate U.S. agricultural production.

To date, there has been little data-based evidence to quantify how many farms would be affected by premium-subsidy caps and how significantly their revenues would decline. R Street Institute Associate Fellow Vince Smith provided answers to these important questions in a recent policy study.<sup>2</sup> Using a data-based simulation, Smith determined how various premium-cap proposals would affect farms across a dozen geographically diverse states and the extent to which affected farms would see a substantial reduction in their gross income from crop operations.

Fortunately for reform-minded congressmen, the answer is clear: a modest cap on crop-insurance-premium supports would not translate to devastating income loss for farms, nor would it destroy U.S. crop production. It would, however, place a meaningful check on the program's growth, reduce taxpayer liabilities and ensure that federal funds aren't used to boost the incomes of wealthy agribusinesses.

### METHODOLOGY FOR R STREET ANALYSIS OF SUBSIDY CAPS

R Street's analysis is based on publicly available data collected by USDA agencies through three major vehicles: the most recent (2012) agricultural census; the annual survey of farms carried out by the National Agricultural Statistical Service; and data on federally subsidized crop-insurance premium rates and program-participation rates collected by the USDA Risk Management Agency. Smith focused on crops that are heavily insured in states that either account for a substantial

**TABLE I: IMPACTS OF ALTERNATIVE PREMIUM CAPS BY STATE**

State	Total farms in all state categories	\$50,000 cap		\$30,000 cap		\$10,000 cap	
		Number of affected farms	Proportion of farms affected (%)	Number of affected farms	Proportion of farms affected (%)	Number of affected farms	Proportion of farms affected (%)
Arkansas	2,345	75	3	369	16	981	42
Georgia	2,833	369	16	981	42	1,528	65
Illinois	36,655	2,761	8	2,761	8	13,775	38
Indiana	22,985	1,393	6	3626	16	6,497	28
Iowa	46,476	41	0.2	144	0.5	2,133	5
Kansas	21,528	32	0.1	192	1	5,759	27
Minnesota	38,697	4,565	12	4,584	12	18,036	47
Nebraska	22,977	5,651	25	10,808	47	16,869	73
North Dakota	17,593	3,979	23	5,592	32	11,160	63
Ohio	24,789	1,671	7	3,883	16	8,545	34
Oklahoma	9,946	104	1	325	3	2,668	27
Texas	7,409	1,692	23	2,950	40	4,959	67
TOTAL	254,233	22,333	9	36,215	14	92,910	37

portion of the total crop-insurance program or whose lobbying groups are particularly active and effective. Six of the states in the analysis are “Corn Belt” states in which corn and soybeans are major crops: Illinois, Indiana, Iowa, Minnesota, Nebraska and Ohio. Three – Kansas, North Dakota and Oklahoma – historically have been viewed as “wheat” states, although North Dakota also has a sizable number of corn and soybean producers. The other states considered were Georgia (cotton and peanuts); Arkansas (rice); and Texas (cotton and wheat).

Using the sources outlined above, Smith identified “representative farms” that would be typical of farms in each state for a range of 11 size categories. For each representative farm, the amount of land planted to each crop and the insurable yield was assumed to be average for the state. Next, Smith identified the typical crop-insurance product used for each representative farm and calculated the farms’ insurance liabilities, total premiums and premium subsidies for each crop.

Using this set of representative farms, Smith was able to assess the impact that various premium-subsidy caps would have on individual farms in each state. A premium cap of \$50,000 has been widely considered and proposed through legislation, while some advocates have proposed caps as low as \$10,000. Smith analyzed the proportion of farms in each state that would be affected by premium-subsidy limits of \$10,000, \$30,000 or \$50,000 and determined the extent to which these farms’ revenues likely would be affected.

**IMPACT OF SUBSIDY CAPS BY STATE**

Smith’s results provide useful insights about the impacts of alternative premium caps. Table 1 summarizes the overall impacts of a \$50,000, \$30,000, and \$10,000 premium-subsidy cap on all farms estimated to produce the six crops under consideration in the 12 representative states.

The analysis reveals that less than 9 percent of the 254,233 farms in the 12 states that plant corn, cotton, peanuts, rice, soybeans and wheat would experience a reduction in their crop-insurance premium-subsidy payments under a \$50,000 premium-subsidy cap. When the size of the payment reductions is considered relative to the farms’ annual revenues from market sales, the impact of the reduction are shown to be small or negligible. Most of the farms affected by a \$50,000 cap have market sales of well over \$750,000 a year and, in many cases, sales are in the range of multiple millions of dollars.

A larger proportion of farms would be affected by a \$30,000 or \$10,000 premium cap. Under a \$30,000 cap, 14 percent of the 254,233 farms would be affected. But again, the impact of the subsidy reductions would likely be small or negligible when considered relative to the farms’ annual market sales. A \$10,000 premium cap would affect 37 percent of the farms, but even here, the reductions would be relatively small and unlikely to cause significant financial hardship.

According to Smith’s calculations, some types of farms would be affected more significantly by premium subsidy caps

than others. For example, about 42 percent of rice farms in Arkansas, where production is dominated by relatively large farms, would be affected by the most stringent \$10,000 premium cap. Such farms typically plant more than 500 acres of rice and see market sales of more than \$700,000 each year. Though some smaller Arkansas rice farms would also be affected by a \$10,000 cap, these operations would only see reductions in their premium-subsidy payments of about \$2,000—less than half of 1 percent of their estimated annual revenues and certainly not sufficiently significant to pose an insurmountable financial burden. Smith also estimated that a \$10,000 premium-subsidy cap would affect 65 percent of the Georgia cotton and peanut farms and 67 percent of the Texas wheat and cotton farms.

The impacts of all premium-subsidy caps generally tend to be lower in most of the Corn Belt states (Iowa, Indiana, Illinois, Ohio and Minnesota) and in Oklahoma and Kansas. Peanut and cotton producers in Georgia, cotton and wheat producers in Texas and corn and soybean producers in North Dakota and Nebraska would feel the impact of the subsidy caps more severely. For a detailed analysis of how the premium-subsidy caps would specifically affect crop growers from each of the states considered, see Smith's full paper.

The analysis reveals that, even though a relatively substantial proportion of farms would be affected by a \$10,000 cap, the resulting reduction in premium-subsidy payment likely would not determine whether a farm is able to stay afloat.

## CONCLUSION

As R Street's analysis clearly shows, even the most stringent payment limits commonly proposed by reform-minded advocates would be unlikely to endanger the economic viability of individual farms. Of course, the question still remains as to what impact such caps would have on the crop-insurance market writ large.

While it's impossible to predict how individual farms will manage risk once they've exhausted their subsidies, evidence from other countries may serve as a helpful guide. Smith notes that farmers in other countries operating under a fixed crop-insurance-subsidy regime tend to use their subsidy to buy coverage for the amount of acres they can purchase at no cost to themselves and then typically decide they can spend their own money more effectively in other ways. As a result, the overall amount of acres insured is likely to decrease if the government limits premium-subsidy payments.

What effect would that have on the crop insurance market? Farm-subsidy supporters have claimed that if large farms purchase less insurance, premium rates will go up for everyone—including small farms struggling to stay afloat. However, this is inconsistent with basic principles of economics,

which suggest that premiums would be likely to decrease if farms no longer over-insure en masse, as there would be more insurance capital available to cover a smaller set of risks. As for the insurance companies, they already enjoy a 14 percent target rate-of-return through the Standard Reinsurance Agreement. Crop insurance has evolved into a booming industry; there's no need to prop up it up by forcing taxpayers to subsidize 62 percent of the premiums for multimillion dollar agribusinesses to purchase as much insurance as they please. Insurance providers and the largest U.S. farm operations are both well-placed to manage risk and cope with modest losses without limitless premium subsidies backed by taxpayers.

While efforts to impose even the most modest caps on premium subsidies are guaranteed to be opposed by inflexible farm-lobby advocates and crop-insurance-industry insiders, the evidence presented in R Street's paper shows that such caps have great potential to make our crop-insurance program more equitable and financially sustainable, without threatening the economic viability of farm operations. Policymakers seeking to level the playing field in the agriculture industry and rein in the ballooning federal program should look to premium-subsidy limits as a crucial first step toward reform.

## ABOUT THE AUTHOR

**Caroline Kitchens** is an outreach associate and policy analyst with the R Street Institute.

Caroline joined R Street from the American Enterprise Institute, where she was a senior research associate in social and cultural studies. At AEI, she co-hosted a popular video blog, *The Factual Feminist*, with Christina Hoff Sommers and was the editor of AEI's *Free-Market Feminist*, a newsletter focused on issues facing women in the modern world. She also managed the book launch of best-selling author Charles Murray's *By the People: Rebuilding Liberty Without Permission*.

Her opinion pieces have appeared in outlets that include *Time*, *U.S. News and World Report* and *National Review Online*. Caroline is a native of northeastern Wisconsin and a graduate of Duke University, where she studied history and political science.

## ENDNOTES

1. Congressional Research Service, "Federal Crop Insurance: Background," Aug. 13, 2015. <https://www.fas.org/sgp/crs/misc/R40532.pdf>
2. Vincent H. Smith, "Limiting premium subsidies for crop insurance," R Street Institute, April 28, 2016. <http://www.rstreet.org/policy-study/limiting-premium-subsidies-for-crop-insurance/>