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THE MYTHICAL 'SAVINGS' OF THE 2014 FARM BILL

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INTRODUCTION

Shortly after the Bipartisan Budget Act of 2015 was unveiled, text of the legislation, which promised to raise the nation's debt limit and set spending levels through September 2017, prompted mayday sirens from both the House and Senate Agriculture committees. Much to the committees' chagrin, the bill's negotiators targeted changes in the U.S. Department of Agriculture's Standard Reinsurance Agreement for federally supported crop insurance as a potential source of budget savings.

The SRA sets the target rate-of-return for insurance companies that participate in the federal crop insurance program, as well as payments to the companies for administrative and operating costs, such as agent commissions. It previously was exempt from being touched by congressional appropriators thanks to a provision in the 2014 farm bill. The Bipartisan Budget Act ordered USDA's Risk Management Agency to renegotiate the agreement with participating insurers and

KEY TAKEAWAYS

- The Agriculture Act of 2014 claimed to achieve \$8.6 billion in savings from agriculture programs, mostly as a result of eliminating direct payments.
- Unfortunately, the massive expansion of crop insurance and the creation of two new support programs, Agriculture Risk Coverage and Price Loss Coverage, has erased much of the promised savings through higher-than-anticipated payouts.
- Reform-minded congressman should resist the claim that our nation's agriculture economy has already paid its "fair share" of deficit reduction and instead seek to place a scope around these ballooning programs.

find \$3 billion in savings, an order members with agricultural constituencies found far too tall.

The House and Senate Agriculture committees almost immediately issued a harshly worded joint release.[1] According to Senate Agriculture Committee Chairman Pat Roberts, R-Kan.: "Farmers and ranchers have done more than their fair share to reduce government spending." Ranking Member Debbie Stabenow, D-Mich., further chimed in:

> "I oppose any efforts to cut or reopen Farm Bill programs… The Farm Bill made meaningful reforms to help reduce the deficit. Any attempts to reopen any part of the Farm Bill to more cuts would be a major set-back for rural America and our efforts to create jobs."

In the words of House Agriculture Committee Ranking Member Collin Peterson, D-Minn.: "We made major cuts when we wrote the Farm Bill. It is not appropriate to cut agriculture again. The Farm Bill should not be raided. I oppose any cuts." For House Agriculture Committee Chairman Mike Conaway, R-Texas, the prognosis was even direr: "Make no mistake, this is not about saving money. It is about eliminating Federal Crop Insurance."

Unfortunately, these overblown warnings were too powerful for Congress to resist; the directive to negotiate more taxpayer-friendly reinsurance deals with private crop insurers was reversed in the highway bill passed in November 2015. But in fact, the arguments made by crop-insurance-subsidy proponents are misleading. Giving in to the committee leaders' line of thinking sets a dangerous precedent, not just for those dedicated to ensuring farm programs are accountable to taxpayers, but also for those dedicated to transparency and accountable spending in all programs.

Beyond the question of whether the federal government should support any large, established industry, or the more specific question of whether that industry could withstand having its taxpayer-supported rate of return lowered from 14.5 percent to 8.9 percent, it's just simply not true that "farmers and ranchers have done more than their fair share to reduce government spending," or that "it is not appropriate to cut agriculture **again"** (emphasis added).

Part of the disagreement stems from discrepancies between the spending that was projected at the time the 2014 farm bill was passed and the actual spending by the USDA over the past two years. While it's true that lawmakers passed legislation that was projected to achieve savings, spending to-date has far exceeded those projections, erasing much of the promised progress. If Congress wants to ensure the nation's agriculture programs don't become unwieldy, ever-growing budget items, understanding the current state of these programs is an important first step.

AGRICULTURE ACT OF 2014

The Agriculture Act of 2014 made a number of important, seemingly promising, changes to federal farm supports. The much-vilified "direct payments" program, which paid a set amount to each farm based on historical farm production, came to an end (for the most part). Subsidized crop insurance and other risk management tools became the main source of federal support for a large number of crops.

Direct payments – originally called "market transition" payments – were created by the 1996 Freedom to Farm Act, when other farm supports wound down to bring the U.S. agricultural support system in line with the nation's international trade commitments. The transition payments represented an effort to break the link between farm supports and crop restrictions, leading to a more liberated agriculture sector. The payments were designed to decline annually and to phase out altogether after five years.

Instead, with farm income falling dramatically, the payments were bolstered, rather than reduced. Despite its reinstatement of other farm supports, the 2002 farm bill still preserved direct payments to farms, regardless of current farm income, acres planted in a given year or overall market conditions.

While breaking the link between government payouts and market choices might have made sense as an effort to free the market from government overreach, the direct payments program rapidly became an unsustainable source of moral hazard in the following years. Congress saw the light in 2014, ending the program. But ending direct payments meant bolstering support elsewhere. This has included expanded support for programs more directly tied to farm decisions and actual production, such as crop insurance and the new supplemental programs created by the bill: Agriculture Risk Coverage (ARC) and Price Loss Coverage (PLC).

The federal crop insurance program is administered by the USDA's Federal Crop Insurance Corp. The FCIC works with private insurers to approve plans available to farmers. Farmers opt in to one of three plan types: yield protection, in which a percentage of expected yield-per-acre is insured at a recent average market price; revenue protection, in which a percentage of expected revenue-per-acre is insured, again with those expectations tied to recent market prices; and revenue protection with a harvest price option, in which a percentage of revenue-per-acre is insured, either at a recent market price or at the eventual harvest price, whichever is higher.

Farmers receive federal assistance to pay their premiums, with an average subsidy of about 60 percent. Participating insurance companies accept a target rate of return, and also receive federal subsidy payments to cover a portion of the administrative and operating costs of offering the policies. When claims rise too high, taxpayers step in to cover insurance company losses through the reinsurance agreement.

Originally designed to insure a select group of staple crops, such as corn, soybeans and wheat, the Agriculture Act of 2014 continued the expansion of crops eligible for federally supported crop insurance. More than 120 crops currently are insurable through the program. The nonpartisan Congressional Budget Office estimated in January 2014 that the final version of the Agriculture Act would increase federal spending on crop insurance by $5.7 billion over the period 2014 to 2023.[2]

The Agriculture Risk Coverage and Price Loss Coverage programs – newly created by the 2014 bill – add additional layers of protection for farm income for growers of staple commodity crops such as corn, wheat and barley. Farm owners can opt in to one or the other, and such decisions last through 2018.

Price Loss Coverage, most commonly chosen by rice and peanut farmers, makes payments when the market-year average price falls below a target known as the reference price. It pays out at 85 percent of the difference between either the reference price and the market price or the reference price and the loan rate, making it similar to older "countercyclical" payment programs.

Agriculture Risk Coverage – the preferred option of corn, soybean and wheat farmers – pays out when revenue falls below a certain threshold. The anticipated revenue can be calculated at either the county level (ARC-County) or the individual farm level (ARC-Individual), but nearly all farms have opted in to county-level program. A target revenue-per-acre is established, and payments are triggered when revenues fall below 86 percent of the target. Payments are made for 65 percent of a farm's acreage for those that participate in ARC-Individual and 85 percent of a farm's acreage for those that participate in ARC-County.

HARVESTING TAX DOLLARS, NOT SAVINGS

Taken together, these two changes – expansion of crop insurance and the creation of ARC and PLC – represented a sweeping overhaul in the federal agriculture support system. However, figuring out the spending implications of these changes is a tricky task.

Because each of these programs is tied in varying ways to market prices and production yields, it's difficult to project anticipated spending. This makes sense intuitively, as the programs are intended to protect against unexpected downturns in the market. When scoring the programs, CBO looked at recent market prices to gauge how much the programs would spend in the coming five years. However, in the years preceding the farm bill, commodity prices and farm incomes were near record highs. Despite warnings that it was illogical to assume these record prices would continue far into the future, spending projections were based on these above-average prices.

The CBO estimated that spending in the commodity title of the farm bill would be reduced by $14.3 billion over 10 years, mostly from the elimination of direct payments.[3] As previously noted, the crop insurance title was projected to boost federal spending by $5.7 billion over 10 years, as the program grew to cover more crops. On net, the farm portion of the bill was expected to save about $8.6 billion.

In their first year of operation, ARC and PLC have come in significantly over budget. According to CBO at the time of the bill's passage, ARC and PLC were expected to cost $3.76 billion in year one. However, recently released information from USDA put spending at $5.18 billion,[4] erasing 16 percent of anticipated savings from agriculture overall. For the fiscal years 2016 through 2018, the CBO projected the ARC and PLC programs would cost $11.6 billion. But new estimates released in January up that projection by roughly 70 percent, to $19.7 billion.[5]

Additionally, in the first year of expanded crop insurance, federal spending totaled $8.24 billion,[6] rather than the projected $6.38 billion, for a cost overrun of $1.86 billion.

These overruns were easily predictable based on market dynamics. Beyond the small likelihood that crop prices would stay at record highs, there are previous examples of egregious overruns. For example, the 2012 drought led to taxpayers paying out $12.07 billion.[7] Coming off the 2012 experience, Congress should have been more careful when expanding crop insurance and other price-based support programs.

POTENTIAL SOLUTIONS

Despite the vociferous objections of the agricultural community's supporters, it is, in fact, possible to rein in this spending and limit taxpayer exposure without destroying the agriculture market. The most important first step is to put reasonable restrictions on crop-insurance subsidies.

Fortunately, precedent also exists for effective ways to limit the program's reach. The direct payments program, which expanded crop insurance and the ARC and PLC programs were designed to replace, contained several restrictions that could be carried over into these programs. First, capping the total premium-support payments any single farm could receive would increase predictability and rein in the amount that flows to the largest, wealthiest farms. As recent R Street analysis demonstrates,[8] a premium-support cap of $50,000, which was considered during the 2014 farm bill debate, would only affect 9 percent of farms, all of which earn incredibly large incomes, most north of $750,000. Even a much stricter payment limit of $10,000 would only affect 37 percent of all farms. Capping these subsidies would be a welcome first step.

Additionally, direct payments were means-tested; crop-insurance supports should be, as well. Several proposals have been floated to do just that, from a modest proposal to reduce support for farms that earn more than $750,000 in adjusted gross income to a more stringent proposal to cut off completely those farms that rake in more than $250,000. Most farms fall well under even this latter lower limit. All reform-minded members of Congress, Republican and Democrat alike, should support ending the flow of subsidies to farms with an income so far above the average household income. Currently, the Assisting Family Farms through Insurance Reform Measures (AFFIRM) Act – sponsored by Reps. Jim Sensenbrenner, R-Wis., and Ron Kind, D-Wis., in the House and by Sens. Jeff Flake, R-Ariz., and Jeanne Shaheen, D-N.H., in the Senate – would enact both a payment limit and a means test. It also would secure a reduction in the target rate-of-return through the Standard Reinsurance Agreement, as proposed at the end of 2015.

Finally, committing to support crop insurance doesn't have to mean committing to support any and all crop-insurance policies at the same level. As discussed above, harvest-price-option policies represent the most egregious risk for taxpayers, as they allow farm owners to rake in more money than was anticipated when the original contract was signed. Withdrawing subsidy support from these policies, while continuing to support the others, would still allow the program to achieve its goals of keeping farms afloat through rough years and protecting taxpayers from lining the pockets of farm owners with extra cash. Rep. John Duncan, R-Tenn., and Sens. Flake and Shaheen have sponsored the Harvest Price Option Prohibition Act to do just this.

For ARC and PLC, the programs are already subject to the $125,000 payment limit of other commodity programs. However, given that spending is projected to be far higher than anticipated, a more stringent cap on these programs is warranted.

CONCLUSION

The federal farm-support system represents an increasingly expensive boondoggle of programs. Despite many attempts at reform, each farm bill is more expensive than the last, and the 2014 bill is no exception. The continued flow of dollars to large, wealthy businesses is unjustifiable and the programs' fiscal trajectory is unsustainable. Simple reforms must be enacted now, despite the egregiously false claims of those who desire to stay on the current path.

Crop insurance, ARC and PLC put taxpayers one bad year away from spending unanticipated billions. Even during good years, the supports serve as an expensive way to shift risk from farms to taxpayers. Congress should review these programs objectively, rather than in the heated battle of year-end budget negotiations. Lawmakers must make the needed reforms to spend tax dollars wisely, rather than sowing seeds for potential fiscal ruin.

ABOUT THE AUTHOR

Lori Sanders is outreach director and senior fellow at the R Street Institute. In this role, she is responsible for R Street's coalition efforts, as well as providing public outreach and education about public policy issues to regulators, lawmakers and their staffs.

Lori came to R Street from the American Enterprise Institute, where she most recently served as program manager for AEI's Road to Freedom project, helping to market AEI President Arthur Brooks' 2012 best-seller The Road to Freedom. Previously, she worked as a development associate in AEI's corporate relations department.

Before her work at AEI, Sanders worked at George Mason University's Mercatus Center, as a participant in the Charles Koch Institute's Koch Associate Program. A native of Macon, Georgia, Sanders is a graduate of Mercer University, where she studied finance and economics.

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