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Crop Insurance and Risk Management: Provisions in the Enacted 1996 Farm Bill

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Summary

Provisions in the Federal Agriculture Improvement and Reform Act of 1996 (P.L. 104-127, the 1996 farm bill) make several changes to the federal crop insurance program administered by the U.S. Department of Agriculture (USDA). Under the new farm law, a producer no longer is required to acquire the minimum level of crop insurance coverage, as long as the producer waives, in writing, any eligibility for future disaster payments. It also allows USDA to continue to offer the basic level of insurance coverage in states or regions that have an insufficient number of approved private insurance providers, but requires USDA to shift policies to private companies when private coverage is adequate. The new law also creates a new Office of Risk Management with jurisdiction over the crop insurance program, and makes seed crops and aquaculture eligible for payments under the noninsured assistance program. Other provisions institute separate pilot programs for insect infestation, nursery crop insurance coverage, futures and options trading, and revenue insurance. The permanently authorized livestock assistance programs, which assist livestock producers when they lose a significant portion of their on-farm feed to a natural disaster, are terminated.

Federal Crop Insurance

Background. The federal crop insurance program, which is administered by USDA's Federal Crop Insurance Corporation (FCIC), is designed to protect crop producers from unavoidable risks associated with adverse weather, plant diseases, and insect infestations. A producer who chooses to purchase an insurance policy must do so by an administratively determined deadline date, which varies by crop and usually coincides with the planting season. Most policies are sold and completely serviced through approved private insurance companies that are reinsured by FCIC. FCIC absorbs a large percentage of the program losses, compensates the reinsured companies for a portion of their operating and administrative expenses, and also subsidizes the premium paid by participating producers.

The Federal Crop Insurance Reform Act of 1994 (Title I of P.L. 103-354) made major revisions to the crop insurance program. The 1994 Act combined a revised federal crop insurance program with a permanent disaster payment program to provide basically “free” catastrophic coverage to all crop producers beginning with the 1995 crop year. Under the law, producers who grow an insurable crop can opt for catastrophic (CAT) coverage which pays participating producers 60% of the estimated market price of the commodity, on crop losses in excess of 50% of normal yield. Producers pay no premium for CAT coverage, but are required to pay an administrative fee of \$50 per crop per county. Producers can also “buy up” to a higher level of coverage by selecting a level of crop yield and price coverage, and paying a premium that increases as the levels of yield and price coverage rises.

Producers who grow a crop that is not covered by the crop insurance program may receive a payment under the noninsured assistance program authorized by the 1994 Act, if areawide losses for that crop are at least 35% of normal yields and the producer experiences a minimum crop loss of 50%. A noninsured producer then receives a payment comparable to an insured producer — 60% of the market price on losses in excess of 50%.

Mandatory Linkage. To help ensure higher rates of participation in the crop insurance program, the 1994 Act made the acquisition of catastrophic risk protection mandatory for any producer participating in the federal price and income support or production adjustment programs or the Conservation Reserve Program (CRP), or receiving a farm loan from USDA. Some farm groups argued that this mandatory linkage to farm programs applied an unnecessary eligibility test that ultimately would discourage participation in both crop insurance and the farm programs. The Administration supported mandatory linkage stating that it was important to ensure sufficient participation in crop insurance to make it a viable program.

One of the primary goals of revising the crop insurance program in 1994 was to eliminate the need for ad hoc disaster payments, which were provided through emergency legislation in nearly every crop year between 1987 and 1994. Critics contended that, in addition to being costly, these ad hoc payments frustrated attempts to encourage high rates of participation in the crop insurance program, since payments were made regardless of whether the producer had an active crop insurance policy. The 1994 Act established legal roadblocks to providing appropriations for emergency disaster payments, by requiring that Congress reduce spending in other areas to offset the cost of providing appropriations for this purpose. Policymakers hoped that this provision coupled with the mandatory linkage to farm programs would ensure higher participation rates in the crop insurance program, and lessen the pressure for appropriations for future ad hoc disaster payments.

Effective for spring planted 1996 crops and all subsequent crops, section 193 of the enacted 1996 farm bill eliminates the mandatory linkage to farm program eligibility for any producer who provides a written waiver to the Secretary agreeing to forego eligibility for disaster payments in connection with the crop. If a producer does not sign a waiver, section 193 requires CAT coverage as a prerequisite for receipt of a CRP payment, a USDA farm loan, or the 7-year market transition payments for eligible wheat, feed grain, cotton or rice growers, newly authorized by the 1996 farm bill.

Dual Delivery System. Some private insurance companies expressed strong reservations about a provision in the 1994 Act allowing producers to secure catastrophic

coverage from either a local USDA office or a private insurance company. The private companies maintained that the private sector is in the best position to counsel producers on their insurance needs, and that a dual delivery system requires additional training and set-up costs to the Federal Government. They also argued that, since levels of coverage beyond the catastrophic level are available only from private companies, a single-point delivery system would provide one-stop shopping for the producer, while producers who purchase their catastrophic coverage from USDA might be less likely to purchase additional coverage. USDA and some farmer groups claimed that the dual delivery system offers farmers greater convenience by allowing them to obtain catastrophic coverage at the same time that they enroll in the price and income support program, and guaranteed widespread, well-serviced delivery of catastrophic coverage.

Section 193 of the enacted 1996 farm bill allows USDA to continue offering catastrophic risk protection through its local offices, but only in states where there is an insufficient number of approved private insurance providers, as determined by the Secretary of Agriculture. By a specific date each year, the Secretary must announce which states are eligible for dual delivery for the following crop year. If the Secretary rules that a state has adequate private coverage, then beginning with the 1997 crop year, all catastrophic policies written by USDA must be transferred to an approved private company if the state has adequate private coverage.

Office of Risk Management. Section 194 establishes a separate Office of Risk Management within USDA which will have jurisdiction over the Federal Crop Insurance Corporation. The FCIC was previously under the jurisdiction of USDA's Farm Service Agency (FSA). The FSA will continue to have jurisdiction over the noninsured assistance program.

Seed Crop and Aquaculture Eligibility. Section 196(a)(2)(B) makes seed crops and aquaculture (including ornamental fish) eligible for coverage under the noninsured assistance program.

Funding of Sales Commissions Reimbursement. Section 193(e) requires the federal reimbursement of sales commissions to private insurance companies for FY1997 to be entirely funded through the Federal Crop Insurance Fund rather than through an appropriation.

Pilot Programs. Section 193(b) and (c) requires USDA to establish a pilot project for crop insurance coverage that would indemnify farmers for crop losses due to insect infestation and disease, and a separate study and pilot program on the feasibility of insuring nursery crops.

Conservation Cross-Compliance. Section 311(2)(B) eliminates a requirement in previous law that required producers to comply with conservation and wetlands requirements in order to be eligible for crop insurance.

Suspension of Livestock Feed Assistance Programs

Section 171(b)(L) of the enacted 1996 farm bill suspends all authority for livestock feed programs through 2002. The Disaster Assistance Act of 1988 (P.L. 100-387) gave the Secretary of Agriculture permanent authority to institute an array of livestock assistance programs in the event of a natural disaster that destroys a significant portion of on-farm feed crops. Over time, USDA frequently implemented two of these measures: (1) the Emergency Feed Assistance Program (EFAP), which provides farmers affected by a disaster with Government-owned grain at a price equal to 50% of the average county market price; and (2) the Emergency Feed Program (EFP), a cost-share program which reimburses livestock farmers up to 50% of the cost of purchased feed.

Options Pilot Program

Under previous farm law, the Secretary was required to operate an options pilot program (through the 1995 crop year on specific crops) to determine whether trading in the futures and options market can be used by producers to obtain protection from price fluctuations. Section 191 of the 1996 farm bill authorizes the Secretary to conduct an options pilot program through 2002 for one or more commodities that currently are supported by a federal program, and as an alternative to any other federal program. The new law allows the Secretary to operate the program in up to 100 counties (a maximum of six counties per state) for a duration in each county not to exceed three of the seven years of program authority. Farmer participation is voluntary. Section 191 prohibits any government agency from guaranteeing participants that they will be better or worse off in the pilot program. The law allows funds to be used from USDA's Commodity Credit Corporation, but requires the Secretary to administer the program in a budget neutral manner, to the maximum extent practicable.

Revenue Insurance Pilot Program

In 1995, some farm groups proposed that one policy tool be implemented to protect farmers from wide variations in both price and output. They suggested a farm revenue insurance program that would combine the production guarantee component of crop insurance with the price guarantee used under the federal price support programs to create a target farm revenue guarantee for every crop farmer. Although a revenue insurance program could be structured in a myriad of ways, a common characteristic of such a program was the establishment of a revenue target for every farmer. Farmers would then be guaranteed that total revenues would not fall below a certain percentage of that target. Participating farmers could be required to pay a premium to share in program costs.

Section 195 of the 1996 farm bill requires the Secretary of Agriculture to carry out a revenue insurance pilot program for crop years 1997 through 2000 for producers of grains and other commodities considered appropriate by the Secretary. The pilot program, which is to be administered by the newly formed USDA Office of Risk Management, must

1) be offered through private insurance companies; 2) provide at least as much coverage as a catastrophic crop insurance policy, 3) require the payment of premiums and administrative fees by participating producers; and 4) must be actuarially sound, that is, total premiums collected must at a minimum cover indemnity payments over the course of the program.

Risk Management Education

Section 192 of the 1996 farm bill requires the Secretary of Agriculture, in consultation with the Commodity Futures Trading Commission, to provide education to agricultural producers on the various risk management tools that are currently available. Under the law, the Secretary may develop and implement programs to facilitate farmer participation in commodity futures trading programs, forward contracting options, and insurance protection program. The Secretary can use existing research and extension authorities and resources to implement this education program.

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