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Crop Insurance Cuts in the Bipartisan Budget Act of 2015

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The House of Representatives and the Senate recently passed the Bipartisan Budget Act of 2015, which allows for raising the federal debt limit and boost federal spending by $80 billion in the next two years. Although this allows the government to pay for its debt obligations, the budget deal required that the increased spending be offset by cuts in other federal programs. One such area is the privately-delivered and publicly-supported Federal crop insurance program, which is now viewed as the most important safety-net mechanism for agricultural producers in the country in light of the cuts to direct payments mandated by the 2014 Farm Bill.

Title II of the newly passed budget bill amends the Federal Crop Insurance Act to require that the Standard Reinsurance Agreement (SRA) between the government and crop insurance companies be renegotiated no later than December 31, 2016 and at least once every five years. This section of the budget bill also establishes an 8.9% cap on the overall rate of return for crop insurance companies. Under the currently negotiated SRA the overall rate of return for companies is set at 14.5%.

The SRA is a contract between the federal government and crop insurance companies detailing the subsidies companies receive for selling and processing policies, and divides any potential profits from policies that don't make a claim (known as underwriting gains). Title II of the new budget bill essentially changes the amount of underwriting gains that the companies can receive, from 14.5% of the premiums paid into the policies that they retain risk of loss, to only 8.9%. The Congressional Budget Office (CBO) scores this provisions as saving $3 billion over 10 years to help offset the expected increase in spending in the coming years.

With these proposed cuts to crop insurance in place, the next issue is to evaluate the likely impact of this provision to farmers. How would these cuts to private companies' underwriting gains affect the ability of growers in North Carolina to manage risk through crop insurance?

As with any controversial budget cutting provision, there are always two opposing views with respect to the effect of these cuts. On one side are the industry groups and their supporters who argue that these cuts would be "devastating" to the industry and will severely affect their ability to deliver crop insurance to our nation's farmers. Hence, farmers would not be able to effectively access these crop insurance policies, affecting their ability to manage risk. The other view is that these companies have earned more than enough underwriting gains over the last decade and that the cuts would still allow them to have a reasonable rate of return. Therefore, our producers will not be adversely affected in this case.

To properly assess the impact of this budget cut to producers, it is first important to point out that the proposed cut in this this budget bill do not directly change the subsidies farmers will receive when they buy federal crop insurance policies. The government will still subsidize over 70% of the total costs of the program and about 60% of the premiums paid into insurance pools to cover indemnity payments for losses incurred by farmers. The proposed cut to the rate of returns of companies will also not affect the premiums that farmers have to pay for crop insurance because premiums for federally subsidized crop insurance policies are determined solely by the US Department of Agriculture's (USDA's) Risk Management Agency (RMA); the agency

in-charge of administrating the federal crop insurance program. Therefore, the subsidy and premium structure of these policies are left unchanged by the new budget act.

With this in mind, the effect of the budget bill on our growers will depend on how the proposed cuts in rate of returns will affect the crop insurance companies' ability to sell and service these policies. But which view are we to believe? The groups which says the cuts will devastate the industry's ability to deliver crop insurance to farmers, or the other groups that says otherwise?

But for the sake of argument here, let's just say that the effect of these cuts will be somewhere in the middle – i.e., it will not totally devastate the crop insurance industry but it would be "painful" enough such that some companies existing now will have to exit the industry. The more cost efficient companies would probably be able to withstand the cut and the less efficient companies would be the ones that would exit. Therefore, agents and adjusters with outstanding books of business that were previously associated with exiting companies are now likely to be absorbed by the other surviving, more efficient companies, while agents and adjusters with not so stellar books may eventually have to exit. This is consistent with the Schumpeterian notion of "creative destruction" within a capitalist economy.

In this scenario, our growers would not be severely affected by the budget cut. The number of agents, adjusters, and companies may decrease but there should still be enough of these private businesses to successfully deliver crop insurance to our producers.

Therefore, producers being substantially affected by the budget deal will greatly depend on whether the proposed cuts are really large enough such that no company will survive in the industry and deliver the policies. However, there are previous analysis that suggest that these companies can survive the magnitude of the cuts in the budget bill (Babcock, 2009) and so it is reasonable to expect that the overall effect on producers may likely be minimal.

With all the discussion about these cuts in crop insurance and its effect on agriculture, there is now talks that rural lawmakers have agreed to "fully reverse" the proposed cuts in a subsequent omnibus spending bill the Congress will need to vote on in mid-December 2016 (Hagstrom, 2015). This means that the language about these crop insurance cuts will remain in the Bipartisan Budget Act but will probably be removed in a subsequent spending bill. In the end, all this hype may be "much ado about nothing."

For More Information:

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Hagstrom, J. (2015). "Senators Vow to Shield Insurance: Vilsack Declines to Say No Cuts to Crop Insurance." DTN The Progressive Farmer. Oct. 29, 2015

Brasher, P. (2015). "Devastating crop insurance cuts sends lawmakers scrambling." *Agri-Pulse*. In: http://www.agri-pulse.com/Devastating-crop-insurance-cut-sends-lawmakers-scrambling-10272015.asp

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