Taxpayers Lose with More Unnecessary Farm Subsidy Layers

Federal farm programs are ripe for reform, especially those that lock in record high prices and guarantee farmers' expected income. As Congress debates a new 5-year Farm Bill, now is prime time to find budget savings in two highly subsidized programs that could easily cost taxpayers $120 billion over the next decade. Together, revenue insurance policies and Average Crop Revenue Election (ACRE), a revenue management program introduced in the 2008 Farm Bill, allow farm businesses to lock in up to 90 percent of their expected income. While businesses in other sectors pay the full cost of their insurance protection, agricultural producers receive ACRE benefits for free and only pay about forty cents on the dollar for federal crop insurance premiums. While certain corn, wheat, soybean, and cotton farmers come out as winners, taxpayers lose.

Instead of reforming these budget-busting farm revenue programs, agriculture interests have proposed increasing the federal role in farm business decisions through new "shallow loss" programs that compensate farm businesses for losses not covered by existing federal crop insurance. The Senate Farm Bill replaced the failed ACRE program with a similar—in title and substance—entitlement called Agriculture Risk Coverage (ARC), while the House Agriculture Committee crafted a program called "Revenue Loss Coverage." In addition, both bills would create two additional shallow loss programs called the Supplemental Coverage Option (SCO) and Stacked Income Protection Plan (STAX); STAX is designed specifically for and available only to producers of upland cotton. Like revenue insurance policies, the alphabet soup of federal shallow loss programs— ACRE, ARC, PLC, SCO, and STAX—are designed to pay out when expected revenue (price x yield) falls below a pre-calculated level. Revenue insurance policies currently lock in up to 85% of income while ACRE and new shallow loss programs generally cover a band from 75% to 90%.

Farmers can currently choose from more than 4,000 different combinations of private and public risk management options.[i] Here, we will examine two of these – ACRE and revenue insurance policies. While ACRE is set to expire, similar programs are proposed to take its place so examining the relationship between revenue insurance and ACRE is important for discussions about the 2012 Farm Bill. In addition, because ACRE and revenue insurance shift risk from farm businesses to taxpayers, several unintended consequences occur including duplicative payments, crowding the private sector out of the crop insurance market, increased pressure on natural resources, and consolidation of subsidy payments in the hands of a few large farm businesses.

Background and Program Descriptions

Agricultural support programs are divided into three main categories – commodity, risk management, and disaster assistance.[ii] Revenue insurance programs fall under the risk management category while ACRE is considered a commodity program. However, lines in the sand are disappearing as programs designed to meet similar goals are added to different categories and sections in the Farm Bill. In this case, the goal is augmenting farmers' income when an estimate of a producer's "actual" revenue falls below an expected level.

1. **Commodity supports**– supplement income regardless of need, or provide subsidy payments when prices or revenue fall for select commodity crops (examples include marketing loans; counter-cyclical, direct, and loan deficiency payments; and **ACRE**)
2. **Risk management** – provides payments when yield or revenue fall for "a much broader set of commodities, including many field and specialty crops and some livestock" (primary example is **federally subsidized crop and revenue insurance**)[iii]
3. **Supplemental disaster assistance** – additional "emergency" payments for weather-related crop losses (examples include the Supplemental Revenue Assistance Payments (SURE) program, and ad-hoc disaster payments authorized by Congress)

Revenue Insurance Policies

When most Americans hear "federal crop insurance," they picture farmers receiving checks for crop losses suffered after a drought or flood. However, for the past 15 years, taxpayers have increasingly subsidized crop insurance policies that protect agricultural businesses from suffering as little as a 15% reduction in expected revenue (price x yield). Today, about 60% of crop insurance policies are revenue guarantee policies, and these account for 80% of taxpayer paid premium subsidies.[iv,v] Here, instead of yield insurance, we focus on revenue insurance since it is increasingly more common, more costly, and most closely resembles ACRE.

Corn, soybeans, wheat, cotton, barley, canola, cherries, sorghum, rice, and sunflowers are all eligible for revenue insurance policies, but the first four account for the greatest portion of taxpayer-subsidized premiums.[vi] Farmers growing these ten crops can enroll in policies like Revenue Protection (RP), Group Risk Income Protection (GRIP), and Crop Revenue Coverage (CRC), to name a few.[vii] These policies are approved by USDA but are delivered through private crop insurance agents at an additional taxpayer cost of $1.3 billion per year.

Average Crop Revenue Election (ACRE) Program

First offered in 2009, ACRE was added as an option to the suite of farm subsidies available to producers after the 2008 Farm Bill. It was designed to cover so-called "shallow losses," defined as drops in expected revenue of just 10% to 25%. Forcing taxpayers to cover these theoretical losses was an unprecedented step into the world of guaranteeing high levels of farm business income. ACRE was intended to reduce systemic risks, including successive years of price declines or yield dips caused by widespread flooding or drought. Like revenue insurance, ACRE subsidy payments are made when individual farm revenue falls below a pre-determined level. Unlike revenue insurance, ACRE also requires states to experience a drop in expected income.

Because one condition of ACRE participation was that producers had to forgo a portion of the direct and counter-cyclical payments they otherwise would receive, the program failed to attract more than 16% of corn, soybean, and wheat farmers in 2010.[viii,ix] Direct payments are made each year regardless of farm income and counter-cyclical payments are made when prices drop below a government-set price. Most producers, particularly cotton and rice growers, opted to remain in the direct payment program since they were receiving a guaranteed check every year totaling up to $96 per acre.[x] Producers of wheat, corn, and soybeans were more likely to enroll in ACRE, since their direct payment checks range from $12 to $24 per acre. Subsidy payments are disbursed by USDA's Farm Service Agency, which also manages direct and counter-cyclical payments.

Program Similarities

ACRE and revenue insurance share more than similar goals. Other similarities include:

- Trade distortions, according to US documentation sent to the World Trade Organization,[xi]
- Favoritism toward large producers growing primarily corn, wheat, soybeans, and cotton,
- No requirement for producers to prove they have actually suffered a revenue loss,
- Potential to be budget busters by locking in current record-high prices, and
- More risk taking through crop plantings on sensitive land like wildlife habitat, native grassland, wetlands, and highly erodible acres.

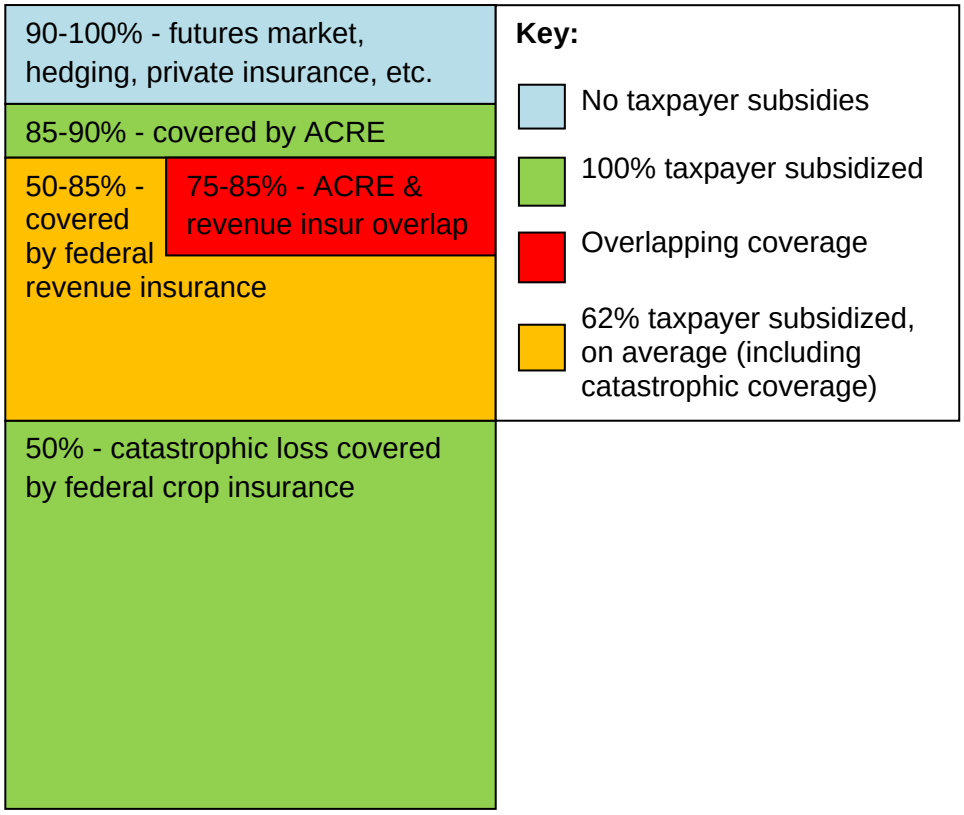
Program Differences

Despite these similarities, ACRE and revenue insurance have inherent differences (see table below). The main differences include the portion of program costs picked up by taxpayers, details of payment calculations, number of years of revenue protection, and whether there are limitations on the amount of subsidy payments. If new "shallow loss" programs similar in substance to ACRE are to be reformed, the intricate details must first be understood.

Program Details	**ACRE[xii]**	**Revenue Insurance Policies**
Fully taxpayer subsidized?	Yes	No – on average, taxpayers subsidize 62% of an individual producer's insurance premiums
Total taxpayer cost	$1.9 billion from 2009-2011 but could exceed $5 billion/year in future, if extended*	$90 billion over next decade (for entire crop insurance program)
Guarantees what percentage of revenue?	Between 75% and 90%	50% to 85%
Payout triggered by	Both state and individual farm revenue falling below a pre-calculated guarantee[xiii]	Individual farm revenue falls below a pre-calculated guarantee
Revenue guarantee based on which price factor?	Average of market prices from previous two years	Annual futures price
Revenue guarantee based on which yield factor?	Both state and farm average yield per acre for previous 5 years minus lowest and highest yields	Most policies based on farm's actual production history; others based on historic county yields
Actual revenue based on which price factor?	30% reduction in national loan rate or average market price	Annual harvest price
Actual revenue based on which yield factor?	Actual state and individual farm yield	Actual individual farm yield; others based on county yield
Length of time for price protection	Guarantee cannot change by more than 10% per year so if prices fall, historic high prices will be locked in for short-term	None; prices change annually
Payment rate	85% of acreage; capped at 25% of overall guarantee	Selected by the producer
Limit on overall payments or subsidies?	Yes; $65,000 payment limit per producer	No limit on premium subsidies or indemnities
* Notes: Economists estimate that if ACRE was in place only for corn and prices dropped sharply, payments could exceed $6.7 billion per year with a 25% payment rate or $4 billion with a 15% payment rate.[xiv] Bruce Babcock of Iowa State University and USDA researchers estimated similar costs.[xv, xvi]		

Overlapping Payments

Since ACRE and revenue insurance programs are designed to cover similar losses, taxpayer dollars are visibly wasted when duplicative payments are made.[xvii] Farmers themselves admit that when more programs are piled on top of one another, overlap occurs.[xviii] If producers enroll in both ACRE and revenue insurance's 85% coverage option, there is a 5% or greater chance that taxpayers will pay not once, but twice for a supposed revenue loss (see graph below).[xix] Agricultural economists across the country have questioned the need for the government to cover small dips in record farm income when farmers could use other time-tested and unsubsidized risk management tools to address the dips, including futures markets, hedging, private insurance policies, and others.[xx, xxi] Protecting against deep, catastrophic losses caused by widespread flooding and drought may be in the taxpayer interest but offering a springboard to perpetual profits is not.



Both taxpayers and farmers would be better off if overlap between these programs was eliminated. Both would save money since crop insurance premiums would cost 10% to 40% less if this important change was implemented, without harming the agricultural safety net.[xxii]

The following simple reforms could be implemented to eliminate duplicative payments, resulting in a win-win for everyone:

- Eliminate taxpayer subsidies for revenue insurance add-on policies,
- Integrate programs by including insurance indemnities in ACRE payment calculations (or vice versa), and
- Cap or reduce payments from ACRE and premium subsidies in revenue insurance.[xxiii xxiv]

Unintended Consequences

With taxpayer subsidies now covering nearly every imaginable business risk for favored crops, unintended consequences are bound to occur. USDA researchers found that as more subsidy layers are added to the risk management cake, farmers are more likely to shift risk onto taxpayers by planting crops on risky, marginal land.[xxv] With subsidies picking winners and losers, farmers plant less diverse rotations in areas receiving the most lucrative subsidies. Finally, most taxpayer-funded ACRE payments and revenue insurance premiums flow to large farmers who are wealthier than the average American.[xxvi, xxvii] As a result, new and beginning farmers are put at a disadvantage as large farmers bid up land prices and increase the cost of entering farming.

Conclusions

Even though ACRE was a failure and revenue insurance has serious flaws, Congress is unfortunately marching down a familiar path without reforming the underlying problem or saying no to new unproven shallow loss programs. If these issues are not addressed and more layers are added to the broken system, taxpayers will be on the hook for expensive, duplicative payments for at least five more years.[xxviii] Instead of guaranteeing record income, subsidized crop insurance should only step in when the private market fails to help farmers recover from severe drought, flooding, or other disasters. Shallow losses should be covered by other risk management tools, like private crop insurance, which will benefit both taxpayers and agriculture in the long-run.

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[iv] http://www.nationalaglawcenter.org/assets/crs/R40532.pdf
[v] http://www3.rma.usda.gov/apps/sob/current_week/insplan2011.pdf
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[viii] U.S. Congressional Research Service. A New Farm Program Option: Average Crop Revenue Election. (ACRE)((R40422; December 10, 2010).
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