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RESEARCH SUMMARY

The US Federal Crop Insurance Program: A Case Study in Rent-Seeking

Crop insurance reform is a major issue in the debate over the forthcoming 2018 Farm Bill. The Trump administration's recent budget proposal included substantial cuts to crop insurance subsidies, cuts that could strike a blow against a program that benefits wealthy interest groups at the expense of taxpayers.

In "The US Federal Crop Insurance Program: A Case Study in Rent-Seeking," Vincent H. Smith, a professor in the Department of Agricultural Economics and Economics at Montana State University, demonstrates that US crop insurance policy has been shaped by a lobbying coalition of farmers and private insurance companies. The result has been a policy that benefits both groups at the expense of taxpayers, despite the lack of an economic justification for the program.

A PROGRAM WITHOUT A PURPOSE

There has never been a solid economic argument for the US federal crop insurance program. Proponents of the program commonly offer three main justifications:

- They argue that lack of all-risk crop insurance constituted a market failure, and the government must step in to ensure that this product is offered. **But the absence of a product does not itself imply a market failure.** It may simply mean that farmers don't think all-risk insurance is worth the cost.
- They argue that insurance companies would never cover crop failures because crop failures are a systemic risk—usually if one farmer experiences a crop loss so do many other farmers, meaning losses are sometimes too widespread to insure against. **But private reinsurance markets already exist to help insurers deal with systemic risk by holding diverse liability portfolios.**
- They argue that reinsurance companies do not have the financial resources to cover major droughts or other extensive causes of crop losses. **But large reinsurance companies can and do cope with much larger losses in other sectors.**

AN ILLUSTRATION IN THREE ACTS

Three acts, passed in 1980, 1994, and 2000, illustrate how crop insurance legislation tends to benefit both farmers and private insurance companies. These benefits come not from better market performance but at the expense of taxpayers—to the tune of $8.5 billion per year.

- The **1980 Crop Insurance Act** introduced a 30 percent premium subsidy, increasing the benefits for farmers and the total revenues to crop insurance companies. This act also required the Federal Crop Insurance Corporation to expand the availability of crop insurance as rapidly as possible, benefitting both farmers and insurance companies.

- The **1994 Crop Insurance Reform Act** reduced the administration and operations subsidies paid to insurance companies from 33 percent to 31 percent. But it counterbalanced this by increasing the crop insurance premium subsidy rate from an average of 30 percent to 50 percent, adding a mandatory surcharge to premiums to cover catastrophic losses (currently 13.4 percent), and introducing new insurance to cover lower-than-expected revenue. The net effect was positive for farmers and insurance companies.
- The **2000 Agricultural Risk Protection Act** mandated an increase in subsidy rates from an average of 50 percent to 62 percent and extended these subsidies to the premiums associated with the harvest price option, a type of revenue-guarantee coverage. These changes increased participation in the crop insurance program from just over 60 percent to 90 percent of the farmland eligible for insurance coverage, benefitting farmers and insurance companies.