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<sup>1</sup> Zacharias, Thomas P. and Keith J. Collins, "Ten Considerations Regarding the Role of Crop Insurance in the Agricultural Safety Net." The piece was published in Choices Magazine, a publication of the AAEA.

# Considerations 5 Through 8: Redux

*This is the third in a four-part series.*

This is the third piece in a four-part series titled "Reconsidering the Considerations." Followers of TODAY® magazine should recall that the motivation for this series was to revisit earlier "Considerations"<sup>1</sup> of the crop insurance program that took place during the deliberations of the 2014 Farm Bill. In our last issue we "Considered" both public interest and taxpayer support for the U.S. farm safety net, along with the advantages of the *ex ante* (before the event) nature of the U.S. crop insurance program.

In this edition we will discuss the Considerations five through eight: Is the safety net income support or risk management; What is the role of area versus individual plans; Is current risk sharing optimal; and should the safety net be incentivized?

## 5. Is the safety net income support or risk management?

The reality is that the farm safety net provides for both income support and risk management. Striking a balance between the two is a function of the current political and economic conditions facing agriculture at a given point in time. The distinction between income support and risk management seems apparent—raising income versus redistributing income across time.

However, this distinction may have blurred over the past several years. Consider the testimony of Dr. Gary Schnitkey, University of Illinois, on June 23, 2021, during the House Agriculture General Farm Commodities and Risk Manage-

ment Subcommittee "Hearing to "Review the Efficacy of the Farm Safety Net."

"According to the Economic Research Service, net farm income...fell from a high of \$140 billion in 2012 to an average of \$74 billion from 2016 to 2019. Incomes rebounded to a forecast of \$123 billion in 2020. Trade disputes, weather issues, along with high yields contributing to abundant supply led to these lower incomes. Without the Federal safety net, farm incomes would have been much lower. Payments for farm safety net programs and net insurance payments were 20% of net income in 2018, 33% in 2019, and 59% in 2020."

In difficult times it is apparent that the farm safety net can and will provide both income support and risk management. This is consistent with the pervasive view that there is public interest and public support for a financially stable agricultural economy. The farm safety net role for crop insurance is to provide risk management in an *ex ante* fashion. Crop insurance has successfully demonstrated that it can perform this role and is popular and trusted by farmers because it is affordable, widely available, and economically viable. It gives farmers the tools they need to tackle the challenges of today and tomorrow. During a recent subcommittee hearing within the House Agriculture Committee, farmers and lawmakers alike described crop insurance as an indispensable risk management tool that continues to grow in necessity as agriculture deals

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with the ill effects of climate change and extreme weather events.

Congressman Glenn “GT” Thompson (R-Pa.), the top Republican on the committee, summed it up this way: “Rather than wait for an act of Congress, farmers need reliable assistance that only a standing program can provide and there is no better example of a program that responds quickly when needed than crop insurance.”

Congresswoman Angie Craig (D-Minn.) also noted in her testimony before the subcommittee that conversations with her constituents had made it clear that “risk management tools like crop insurance are more important than ever. Federal crop insurance has been a success story because it’s actuarially sound and consistently works for farmers.”

#### 6. Is current risk sharing optimal?

Risk sharing is a fundamental element of the Federal crop insurance program. Descriptively, the current risk-sharing arrangements are set out contractually at several levels: a) the Standard Reinsurance Agreement (SRA), the risk sharing arrangement between the Approved Insurance Providers (AIPs) and U.S. Department of Agriculture; b) the actual crop insurance policy between the farmer and the AIP; c) the contractual arrangements between the crop insurance agents and the AIPs; and d) the reinsurance treaties between the re-insurers and the AIPs.

The AIPs bear a portion of the risk, farmers shoulder a portion of the loss through their deductibles, and the government provides both premium support and reinsurance. Two advantages of the current system are: 1) risk sharing reduces taxpayer exposure; and 2) risk sharing incentivizes program stakeholders to minimize losses.

Is the current system optimal? Perhaps the better question is whether alternative risk shar-

ing arrangements benefit one set of stakeholders without negatively impacting someone else? Over time, the legal and regulatory structure of the program has enabled stakeholders to reassess and recalibrate the degree of risk held by a particular program participant. The key takeaway here is that the system can adapt, and risk sharing can be successfully modified to reflect changing economic and political environments.

#### 7. What is the role of area versus individual plans?

Over the last decade, there have been considerable developments in area-based and/or parametric (index-based) products. The market shares of area-based and index-based products represented nearly 5% and 10% of MPCPI (standard book of business) premium respectively in 2021. The traditional suite of area plans (commonly known as Area Risk Protection Insurance or ARPI, plans) triggers at the county level and are designed to work separately from individual plans. The 2014 Farm Bill introduced two new area-based supplemental revenue products: Supplemental Coverage Option (SCO) and Stacked Income Protection (STAX). SCO supplements underlying individual crop insurance policies and its coverage depends on the underlying crop insurance plan and coverage. To date, SCO has experienced modest uptake. Similarly, the Stacked Income Protection (STAX), the other area-based supplemental program, was introduced for cotton. STAX has also seen limited uptake. Most recently, the Enhanced Coverage Option (ECO) products were introduced. These are again area-based supplemental products, protecting a portion from 90 percent or 95 percent, down to 86 percent of the deductible with the underlying base plan of insurance. ECO products were developed privately. Lastly, Margin Protection (MP) products protect against profit margin

losses and were first introduced in 2017 for corn and 2018 for soybeans. MP products were again privately developed and can be used as a stand-alone coverage or in conjunction with the underlying individual coverage.

As for the parametric insurance, the Hurricane Insurance Protection – Wind Index (HIP-WI) Endorsement was introduced in 2020. HIP-WI is a single peril insurance product that covers only named hurricanes. HIP-WI is sold primarily in the Southeastern U.S. where adoption of individual coverage plans has been relatively low. The Pasture, Rangeland, Forage Rainfall Index (PRF-RI) product was introduced in 2007 and has expanded in recent years.

It appears that area-based and/or index-based products will continue to coexist with individual plans in the future. If risk minimization is to be a policy objective, these products should be designed to ensure that farmers’ choices of individual coverage are not distorted, but rather work as complementary to individual plans and fill the remaining gaps in insurance coverage.

#### 8. Should the safety net be incentivized?

It is reasonably safe to conclude that the modern-day crop insurance program is largely incentive based. The purchase of crop insurance is incentivized by offering farmers premium support. Sales of crop insurance are incentivized by agents’ commissions. When companies share in the risk of the policy, it incentivizes them to pay claims accurately, thereby reducing the potential for program fraud, waste, and abuse.

Perhaps one of the better examples of the effectiveness of incentives in crop insurance is the ability of the insurance companies to compete and expeditiously service claims. Two examples come to mind. During the 2011 drought, Texas farmers whose crops were lost had been paid \$121 million in indemnities by mid-July 2011. By



mid-December, more than \$2 billion had been paid, ensuring farmers would be able to stay in business and plant crops the following year. In 2019, farmers across the Midwest were unable to plant 18.7 million acres due to excessive moisture in the winter and early spring. By mid-July 2019, farmers were paid roughly \$500 million in Prevented Planting indemnities and by the end of October, more than \$4 billion had been paid. Both examples demonstrate how quickly the crop insurance industry can respond when disasters hit. Both examples also demonstrate the benefit of incentivized service.

*Author's Note: The author appreciates the comments and suggestions of Harun Bulut, Mickey Paggi, and Phillip Hayes. All remaining errors are my own.*

## In This Issue

This summer, NCIS had the honor of hosting students from three 1890 universities for a summer long virtual internship. The program provided the interns with an in-depth look at how the crop insurance program works and its importance to America's farmers and ranchers. You can learn more about Paris, Erikton, and Niaviana in their article beginning on page 12 and read about what they learned during their 10 weeks with NCIS.

Alyssa Milliken, who has been an NCIS intern the last couple of years, wrote an article covering the recent Train the Trainer virtual conference held in July. There was a lot of important information shared during that event, including hearing from special guest speaker, Karis Gutter, on

the importance of diversity in the workplace.

Also, in this issue we provide the 2020 NCIS agronomic research results from 12 projects across the United States. These results, in conjunction with those from previous projects, are used to verify and improve current NCIS loss adjustment procedures. The NCIS agronomic research program is vital to ensure claims are paid accurately and fairly.

We also introduce you to fourth generation farmer, Sarah Zost, from Pennsylvania. She and her family rely on crop insurance to help their farm survive if disaster strikes, as it did in 2020. Lastly, we provide the final 2020 premium and loss statistics for both the Federal and Crop-Hail insurance programs. We hope that you enjoy all that this issue has to offer.

# Submit Your Nominations

The NCIS Industry Awards were established in 2001 to honor individuals who provide exemplary service to the crop insurance industry. The awards recognize individuals who consistently demonstrate outstanding leadership by their willingness to serve the industry and by going above and beyond their roles with their individual companies.

## Award Categories

**FRIEND OF THE INDUSTRY**—Recognizes an individual, working directly in the crop insurance industry or other organization.

The individual has provided exceptional and notable contributions, and exhibited outstanding leadership and guidance to, and knowledge of, the crop insurance industry.

**OUTSTANDING SERVICE**—Presented to a crop insurance agent, or individual outside the industry, who provides exceptional service and outreach efforts industry-wide to all farmers, especially limited resource and/or socially disadvantaged farmers.

**INDUSTRY LEADERSHIP**—Primarily recognizes members of the NCIS regional/state crop insurance and/or NCIS standing committees.

This award recognizes individuals who consistently serve the industry with outstanding leadership and service to regional/state and/or a standing committee.

**LIFETIME ACHIEVEMENT**—Presented to those people who have served, or are currently serving, in leadership capacities within the industry and exhibit(ed) outstanding leadership, guidance and knowledge to and of the crop insurance industry.

**Visit [CropInsuranceInAmerica.org/resource-materials/](https://CropInsuranceInAmerica.org/resource-materials/) for more details about the awards, guidelines for nominating candidates, and to download forms for submitting your nomination.**

**All nominations are reviewed by the NCIS Communications & Outreach Committee, with final nominees approved by the NCIS Board of Directors.**



National Crop Insurance Services®

# NCIS Industry Awards

**Nominations must be submitted in writing to NCIS by October 15, 2021, for awards to be presented at the 2022 Annual Convention. If you have questions regarding the criteria for the awards, please contact Laurie Langstraat, NCIS at [lauriel@ag-risk.org](mailto:lauriel@ag-risk.org) or 913-685-2767.**