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Boom Times for Crop Insurance

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Crop farmers are enjoying record high profits because of dramatically higher market prices. Farmers’ increased demand for land, seed, fertilizer, and machinery has resulted in higher prices and profits for sellers of these inputs as well. One industry that is also enjoying the higher crop prices is the crop insurance industry. It benefits from higher prices because the formulas used to determine industry revenue automatically generate higher expected subsidies as crop prices rise. Actual subsidies depend in part on crop losses, but administrative and operating subsidies are directly tied to crop prices. Figure 1 shows how total industry revenues from insuring the nation’s corn, soybean, wheat, and cotton farmers have risen in recent years. Revenues could rise by another 25 percent in 2008 if crop losses are similar to those in 2007.

You might think that the formulas used to subsidize the industry would be tied to industry workload or effort rather than crop prices. After all, rarely are government-paid salaries tied directly to a commodity price. But as shown in Figure 2, the number of corn, soybean, wheat, and cotton policies written since 2000 has been flat. That is, agent and company workloads since 2000 for these four crops have not increased, yet agent commissions over this time have increased by a factor of four.

The salaries of crop insurance company employees and claims adjustors are largely determined by market forces. After all, why should the salary of a crop insurance company vice president or computer programmer be any higher than needed to keep that employee in the job? A recent report sponsored by National

Figure 1. Total crop industry revenue from corn, soybeans, wheat, and cotton since 2000

Figure 2. Policies serviced for four crops and associated total agent commissions
Crop Insurance Services shows that all cost categories but one have largely tracked with general labor markets. The one exception is agent commissions, which track directly with crop prices and premiums in the program. As shown in Figure 3, this means that the commission per written policy has increased from $351 per policy in 2000 to an estimated $1,357 per policy in 2008. The reason for this rise in agent commissions is that under crop insurance rules, companies cannot compete on the prices of policies because these are set by the government. The only way for companies to compete with each other is to vie for agents’ policies. This competition results in changes in taxpayer subsidies being directly reflected in agent commissions.

Note: Policy numbers are calculated from data obtained from the RMA Summary of Business Reports. Commissions are calculated from “Federal Crop Insurance Program Profitability and Effectiveness Analysis, 2007 Update,” prepared on behalf of the National Crop Insurance Services by Grant Thornton LLP.

Figure 3. Agent commission per corn, soybean, wheat, and cotton policy sold

Corn Belt Contributions to the Crop Insurance Industry
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to generate reserves to cover years with negative underwriting gains. However, farmers in the Corn Belt are beginning to wonder whether crop insurance is such a good deal for them. Why should they be asked year after year to generate large underwriting gains so that the industry will be willing to offer insurance in other states? Why should they keep generating excessive annual agent commissions when they rarely receive payments that exceed their premiums? Since 2000, agent commissions on policies sold to corn and soybean farmers in Iowa, Illinois, and Indiana have totaled more than $933 million, whereas corn and soybean farmers in these three states have paid $768 million more in premiums than they have collected in indemnities.

The initial push in early 2007 by the National Corn Growers Association to include a county revenue countercyclical program in the new farm bill reflected a belief by corn farmers that a reduction in the role of the crop insurance industry as a risk-management middleman would better serve both farmers and taxpayers. Their county program was immediately opposed by the crop insurance industry because it would have dramatically increased the proportion of taxpayer subsidies that would have flowed directly to farmers. Given the results of the analysis shared here, it is clear why their proposal was also attacked by politicians and commodity groups from Great Plains states: reducing participation in crop insurance by Corn Belt farmers would dramatically reduce industry profits, which would threaten the willingness of companies to insure farmers in states where premiums have not kept pace with losses.

It’s possible that an optional state-level revenue countercyclical program will emerge in the new farm bill. However, it would not be surprising if those farmers who opt for this policy will be required to purchase crop insurance. Such a requirement would reflect the influence of industry interests that are aligned with regional interests in maintaining, for as long as possible, the current structure of the program.

Note of Disclosure: The author has worked as a consultant for the National Corn Growers Association estimating the cost of various farm bill alternatives.