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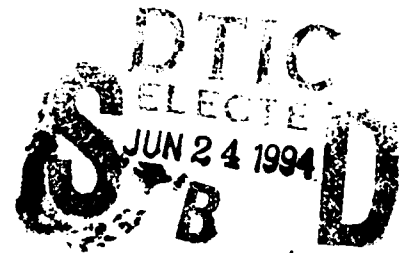


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Roles, Cost, and Criteria for Assessing Agriculture
Disaster Assistance Programs Between 1980 and 1988

Statement of
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Agriculture Issues
Resources, Community, and Economic
Development Division

Before the
Subcommittee on Agricultural Production
and Stabilization of Prices
Senate Committee on
Agriculture, Nutrition and Forestry
United States Senate



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Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to discuss the federal government's responses to natural disasters affecting American agriculture during the 1980s. Our testimony will address (1) the Department of Agriculture's (USDA) role in providing agricultural disaster assistance since 1980, including the cost of providing this assistance, and (2) criteria for assessing the federal role in providing disaster assistance to farmers and how well current programs meet these criteria. My statement today is primarily based on a GAO report issued in September 1989.¹

In summary, USDA has provided disaster assistance to farmers through direct cash payments, subsidized emergency loans, and a crop insurance program. Between fiscal years 1980 and 1988, the federal government has incurred costs of approximately \$17.6 billion in support of these programs: \$6.9 billion for direct cash payments, \$6.4 billion for disaster emergency loans, and \$4.3 billion for crop insurance.

In developing criteria for determining the best way to provide disaster assistance, we relied on two basic principles--equity and efficiency. Under an equitable program, disaster victims should be treated consistently over time. With an efficient program, costs

¹Disaster Assistance: Crop Insurance Can Provide Assistance More Effectively Than Other Programs (GAO/RCED-89-211, Sept. 20, 1989).

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should be minimized. On this basis, we identified eight criteria that should be considered in devising an effective disaster assistance program.

Application of our criteria to the three existing programs shows that crop insurance satisfies more criteria than the direct payments or emergency loan programs. Specifically, we found that crop insurance would satisfy 3 of the criteria, while direct payments would satisfy 1, and emergency loans none. We also found that if some program characteristics were changed, crop insurance could satisfy 7 of our criteria, and the direct payments and emergency loan programs 4.

In concluding that crop insurance is a better way of providing disaster assistance than either the direct payment or emergency loan programs, we believe that the real effectiveness of the program cannot be fully determined as long as it has the disadvantage of competing with the other disaster assistance programs. Consequently, if the Congress chooses to rely on crop insurance as the primary method of providing disaster assistance, it should prevent other disaster assistance programs from competing with it.

FEDERAL ROLE AND COSTS IN PROVIDING AGRICULTURE

DISASTER ASSISTANCE BETWEEN 1980 AND 1988

Let me now briefly discuss the federal role and costs in providing agriculture disaster assistance since 1980.

Throughout the 1980s, USDA has been responsible for administering three types of disaster assistance programs--direct cash payments, subsidized loans, and subsidized insurance. Each of these programs helps farmers deal with a loss of income if their crops are damaged or destroyed by natural causes.

Before 1980, USDA provided disaster assistance mainly through direct cash payments and loans. New legislation was enacted in 1980 that greatly expanded the scope and availability of crop insurance.² At the time, the Congress believed that an expanded crop insurance program covering more crops and a larger part of the country would alleviate the need for expensive, ad hoc disaster assistance programs.

Despite the expanded scope and availability of crop insurance, the Congress has continued to provide disaster assistance to farmers through direct payment and emergency loan programs during the 1980s because crop insurance participation

²The Federal Crop Insurance Act of 1980 (P.L. 96-365, Sept. 26, 1980).

rates have remained relatively low.³ Low participation rates, in turn, have encouraged the Congress to establish ad hoc disaster assistance programs, which further undermined crop insurance participation. This cycle of initially low participation rates leading to competing programs, which further discouraged farmers from purchasing crop insurance, limited the program's effectiveness and led us to today's dilemma of providing competing disaster assistance programs.

From 1980 through 1988, USDA spent approximately \$17.6 billion to support the direct payment, emergency loan, and crop insurance programs. As indicated in chart 1, total costs for all three programs have increased every year since 1984. Chart 2 shows the costs for each of the three programs for fiscal years 1980 through 1988.

Direct payments have cost a total of \$6.9 billion, reaching peaks of \$1.4 billion in 1981 and \$4 billion in 1988 as a result of especially severe droughts in those years. The costs of the Disaster Assistance Act of 1988,⁴ which include 1989 outlays, are included in chart 2 under costs for fiscal year 1988.

³Since 1980, the amount of eligible acres enrolled in the program has risen from 9.6 percent in 1980 to 24.5 percent in 1988, well below the 50-percent target established for the program in 1980. In response to the severity of the 1988 drought and crop insurance purchase requirements, participation rates rose to about 40 percent in 1989.

⁴P.L. 100-387, Aug. 11, 1988.

USDA's emergency loan program costs were \$6.4 billion from 1980 through 1988 and have been increasing steadily throughout the decade. Specifically, emergency loan program costs have risen from \$245 million in 1980 to over \$1.6 billion in 1988. Although most of the total costs have been due to interest subsidies, an increasing part of the rise in costs has been due to rapidly increasing loan defaults leading to debt write-offs.

The federal share of crop insurance costs since 1980 is about \$4.3 billion. As was the case for other forms of disaster assistance, the federal costs for supporting crop insurance also increased during the decade. Total government contributions for the crop insurance program increased from \$28 million in 1980 to \$1.2 billion in 1988.

CRITERIA FOR ASSESSING CURRENT
DISASTER ASSISTANCE PROGRAMS

Now, I shall briefly discuss our criteria for assessing federal disaster assistance programs to farmers and how well current programs meet these criteria.

In developing these criteria, we have taken the position that the policy principles of equity and efficiency are essential elements of any desirable disaster assistance program. These

principles suggest that an equitable disaster assistance policy ensures that aid is provided consistently to victims suffering from similar losses over time. An efficient disaster assistance policy ensures that benefits are provided at the lowest possible cost to government and to society as a whole. In our opinion, an equitable and efficient disaster assistance policy should

- (1) determine compensation by the amount of a farmer's loss, not by the severity of the disaster,
- (2) provide similar amounts of assistance to farmers suffering similar amounts of losses,
- (3) not provide farmers more assistance than the amount of their disaster losses,
- (4) not create incentives to encourage farming practices that increase the likelihood and extent of losses,
- (5) make the programs consistently available over time to allow for long-range planning,
- (6) help farmers withstand and recover from the effects of natural disasters,
- (7) provide predictable annual costs, and

(8) meet their objectives at the lowest possible cost.

Our analysis of how well each of the current programs satisfies these 8 criteria shows that the crop insurance program satisfies 3, the disaster payments program satisfies 1, and the emergency loan program satisfies none. (See app. 1.) If some program characteristics were changed, these programs could satisfy 7, 4, and 4 criteria, respectively.

Our first criterion is that the amount of disaster assistance provided should be determined by the amount of a farmer's loss, not by the severity of the disaster. Crop insurance meets this criterion. The direct payment and emergency loan programs do not. Ad hoc approaches to disaster assistance policy, in which disaster relief programs or program terms are established after the major disaster has occurred, can result in different treatment for similarly affected disaster victims. In contrast, the terms of compensation under crop insurance are determined before a disaster occurs and, therefore, crop insurance provides farmers equitable assistance more consistently.

Our second criterion is that disaster assistance programs should provide similar amounts of assistance to farmers suffering from similar amounts of loss. None of the programs meet this criterion. All three programs provide some disaster benefits

indirectly through the tax code, primarily as deductions to income. Because the value of these deductions is higher for taxpayers in higher tax brackets than for taxpayers in lower tax brackets, similarly affected disaster victims may obtain different levels of total assistance from a given program if they are in different tax brackets. Because emergency loan recipients can deduct their entire disaster loss, and direct payment and insurance recipients cannot, tax benefits under the emergency loan program may be more substantial than under the other two programs.

Our third criterion is that disaster assistance programs should not provide farmers more assistance than the amount of their disaster losses. None of the programs meet this criterion, but they could with program changes.⁵ Farmers in all three programs may receive disaster assistance on the basis of county average production data, which can be higher than their actual production histories. Therefore, under some circumstances, farmers can be compensated for more than their losses under all three programs.

Criterion four is that disaster assistance programs should not create incentives to encourage farming practices that increase the likelihood and extent of losses. None of these programs meet this criterion, but they could come closer to meeting the criterion with program changes. Subsidized disaster assistance programs

⁵In the following discussion, program changes needed for programs to meet criteria are identified as footnotes in appendix I.

discourage farmers from taking risk-reducing measures because, with subsidies, farmers may be able to obtain disaster assistance that provides nearly complete protection at a cost lower than prevention. Generally, the more a program is subsidized, the less likely it is that farmers will try to reduce risks. To the extent that all three programs are subsidized, they do not meet this criterion.

Criterion five is that disaster assistance programs should be consistently available over time to allow for long-range planning. Crop insurance meets this criterion. The direct payment and emergency loan programs do not. As other business managers, farmers must make decisions about risk and the extent of protection their enterprise requires from events beyond their control. For example, the availability of direct payment and emergency loan programs has varied significantly over time, making it difficult for farmers to develop risk management plans. In contrast, crop insurance has provided disaster assistance more reliably. Once a crop insurance program has been established in a county, it has remained available for farmers in that county year after year.

Criterion six is that disaster assistance programs should help farmers withstand and recover from the effects of natural disasters. Crop insurance and the disaster payment program meet this criterion. The emergency loan program does not meet this criterion, but it could with program changes. Simply put, disaster

assistance experience in the 1980s indicates that cash assistance, in the form of direct payments or insurance indemnity payments, helps farmers recover better from natural disasters than assistance in the form of loans. Loan programs do not provide farmers any of their expected income (unless the loan is forgiven) and increase farmers' debt burdens, which makes it difficult for some farmers to obtain financing for normal operations and to recover from future disasters.

Criterion seven is that disaster assistance programs should have predictable annual costs. Crop insurance does not meet this criterion, but it could with program changes. The direct payment and emergency loan programs cannot meet this criterion. Costs could be made more predictable if the programs were managed in a way in which program costs are determined in anticipation of catastrophic events. Neither the direct assistance nor emergency loan programs have predictable costs. And although crop insurance was established to operate this way, it also does not have predictable costs because in only about one-half of the current program do policy premiums reflect the true risk of written policies.

Our last criterion is that disaster assistance programs should meet their objectives at the lowest possible cost. None of the three programs meet this criterion, but they could with program changes. As noted earlier, disaster assistance programs can meet

their objectives at lower costs by incorporating incentives to reduce risky farm practices. However, subsidized disaster assistance programs discourage farmers from taking risk-reducing measures. Therefore, none of the three programs fully meet this criterion because all are subsidized.

In addition, offering farmers more than one form of disaster assistance, as in 1986 and 1988, increases the probability that USDA would spend more for disaster assistance than if only one form of assistance were available to a farmer. For example, more could be spent when ad hoc direct payment programs provide crop insurance policy holders additional benefits so they are not penalized for purchasing insurance.

OBSERVATIONS

In concluding that crop insurance meets more of these criteria than other forms of assistance, we recognize that the crop insurance program has had a history of management problems that, in the short term, makes it difficult to justify the current crop insurance program as the sole source of disaster assistance to farmers. Consequently, if the Congress chooses to rely on the crop insurance program exclusively to provide crop disaster assistance, a transition period for strengthening the program probably would be necessary.

Another critical problem that the crop insurance program faces is that it has had to compete throughout the 1980s with direct assistance and loan programs, which have received larger amounts of federal funds and have had more attractive terms for farmers. Consequently, its participation rates have remained low, and it has never developed an actuarially sound program. We believe a restructuring of the agriculture disaster assistance programs that removes this disadvantage could help determine how effective the crop insurance system can be.

We also recognize that crop insurance is only appropriate for compensating victims who lost crops owing to a disaster. Other forms of assistance, including alternative insurance programs, would be more suitable for disaster-caused damages to farming and ranching infrastructure, such as the destruction of a barn, to help restore the productive capacity of a producer's enterprise.

As you know, Mr. Chairman, the Administration, in its 1990 Farm Bill proposals, recommends replacing the crop insurance program with a legislated disaster assistance program similar to the 1988 and 1989 disaster payment programs. The new program would provide direct payments for individual losses whenever county-wide harvested yields fell below 65 percent of normal yields on a crop-by-crop basis. We have not studied the Administration's proposal in detail. However, because the Administration's proposal is similar to previous disaster payment programs, we believe crop

insurance, as we stated earlier, would be a more equitable and efficient way to provide disaster assistance.

Mr. Chairman, this concludes my prepared statement. My colleagues and I will be happy to answer any questions you may have.

Chart 1: Government Costs for Agriculture Disaster Assistance Programs (FY 1980-88)

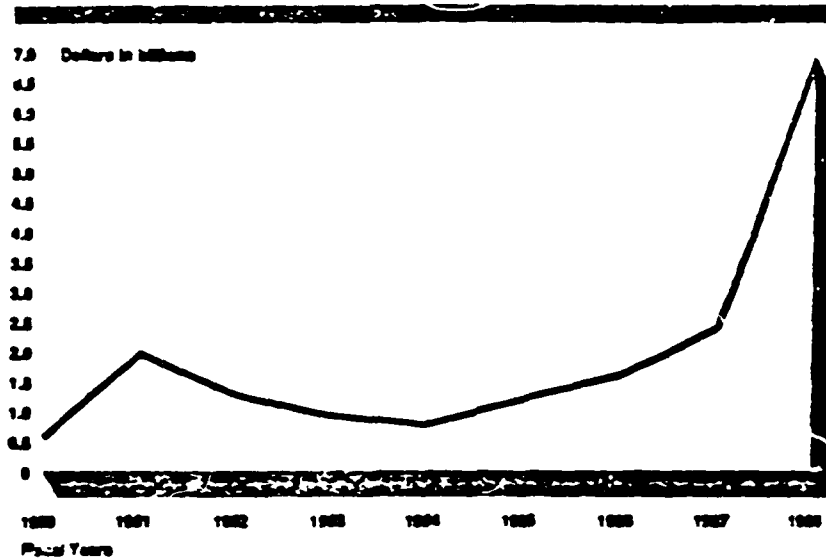
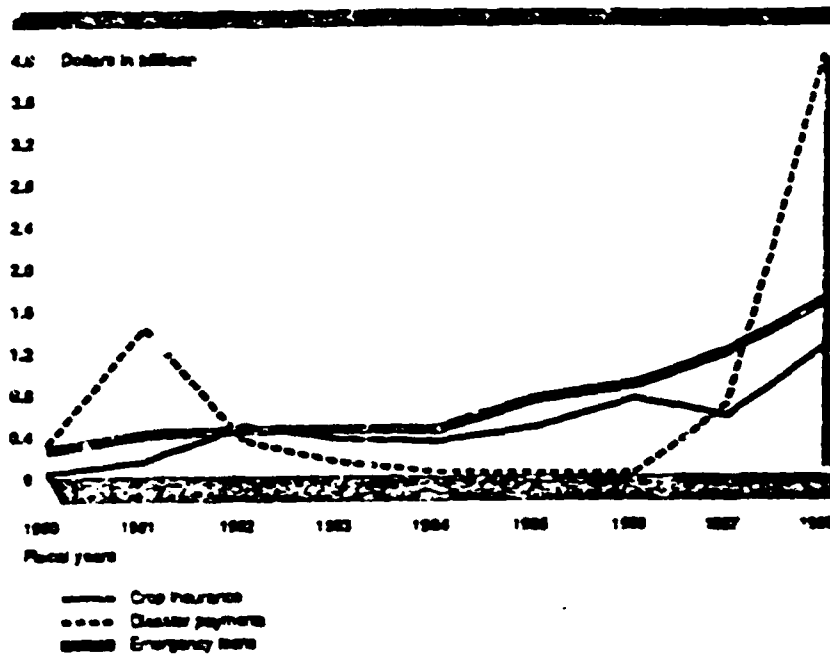


Chart represents actual government costs not adjusted for inflation.

Source: USDA

Chart 2: Government Costs for Direct Payment, Emergency Loan, and Crop Insurance Programs (FY 1980-88)



Totals for FY 1988 include disaster assistance payments made in FY 1988. Administrative costs for FY 1980 are not included.

Total emergency loan administrative costs for FY 1980-81 are not included. Administrative costs for those years only include money received from the revolving fund.

Source: USDA.

CHART SHOWING HOW WELL DIFFERENT FORMS
OF DISASTER ASSISTANCE MEET THE CRITERIA

<u>Criteria</u>	<u>Crop Insurance</u>	<u>Disaster Payments</u>	<u>Emergency Loans</u>
1. The amount of disaster assistance provided should be determined by the amount of a farmer's loss, not by the severity of the disaster.	Yes	No	No
2. Disaster assistance programs should provide similar amounts of assistance to farmers suffering similar amounts of losses.	No	No	No
3. Disaster assistance programs should not provide farmers more assistance than the amount of their disaster losses.	Depends ^a	Depends ^a	Depends ^a
4. Disaster assistance programs should not create incentives to encourage farming practices that increase the likelihood and extent of losses.	Depends ^b	Depends ^c	Depends ^b

^aWould meet criterion if actual production histories were used exclusively.

^bWould meet criterion to the extent that programs were not subsidized. For crop insurance, incentives would be reduced to the extent that premiums reflected actual risks and that subsidization of high-risk participants by low-risk participants was minimized.

^cWould meet criterion to the extent that losses are only partially compensated and that compensation for risky farming practices was prohibited.

APPENDIX I

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<u>Criteria</u>	<u>Crop Insurance</u>	<u>Disaster Payments</u>	<u>Emergency Loans</u>
5. Disaster assistance programs should be consistently available over time to allow for long-range planning.	Yes	No ^a	No
6. Disaster assistance programs, in the way they provide financial assistance, should help farmers withstand and recover from the effects of natural disasters.	Yes	Yes	Depends ^b
7. Disaster assistance programs should have predictable annual costs.	Depends ^c	No	No
8. Disaster assistance programs should meet their objectives at the lowest possible cost.	Depends ^d	Depends ^e	Depends ^d

^aThe Emergency Feed Program and the Emergency Feed Assistance Program are consistently available to producers to help them with long-range planning.

^bMeets criterion only to the extent that loan principal is forgiven.

^cMeets criterion to the extent that the program is run on an actuarially sound basis.

^dWould meet criterion to the extent that programs were not subsidized. For crop insurance, incentives would be reduced to the extent that premiums reflected actual risks and that subsidization of high-risk participants by low-risk participants was minimized.

^eWould meet criterion to the extent that losses are only partially compensated and that compensation for risky farming practices was prohibited.