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# WASTE, FRAUD, AND ABUSE IN THE FEDERAL CROP INSURANCE PROGRAM

## HEARING

BEFORE THE

## COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

## HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

FIRST SESSION

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# WASTE, FRAUD, AND ABUSE IN THE FEDERAL CROP INSURANCE PROGRAM

**THURSDAY, MAY 3, 2007**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM,
*Washington, DC.*

The committee met, pursuant to notice, at 10 a.m. in room 2157, Rayburn House Office Building, Hon. Henry A. Waxman (chairman of the committee) presiding.

Present: Representatives Waxman, Maloney, Cummings, Kucinich, Clay, Watson, Yarmuth, Braley, Cooper, Hodes, Davis of Virginia, Platts, Duncan, Turner, and Sali.

Staff present: Phil Schiliro, chief of staff; Phil Barnett, staff director and chief counsel; Brian Cohen, senior investigator and policy advisor; Margaret Daum, counsel; Earley Green, chief clerk; Teresa Coufal, deputy clerk; Matt Siegler, special assistant; Zongrui "JR" Deng, chief information officer; Miriam Edelman and Will Ragland, staff assistants; David Marin, minority staff director; Larry Halloran, minority deputy staff director; Jennifer Safavian, minority chief counsel for oversight and investigations; Keith Ausbrook, minority general counsel; Ellen Brown, minority legislative director and senior policy counsel; Anne Marie Turner, minority counsel; Patrick Lyden, minority parliamentarian and member services coordinator; Brian McNicoll, minority communications director; and Benjamin Chance, minority clerk.

Chairman WAXMAN. The meeting of the committee will please come to order.

Our committee started this year with 4 days of hearings on waste, fraud and abuse. We examined why $12 billion in cash disappeared in Iraq. We looked at the problems created by our Government's growing reliance on private security contractors, and we investigated the calamitous Deepwater contract to build ships for the Coast Guard. We also held a day of hearings on waste, fraud and abuse in the healthcare system.

This a theme that we will return to repeatedly this year. The taxpayers understand it costs money to run the Government, but they can't accept rampant waste, fraud and abuse that squanders their money on boondoggle programs. They are looking to Congress to rein in the wasteful spending and Federal giveaways that are driving our Nation deeper into debt.

Our committee is uniquely positioned to week out waste, fraud and abuse. Because we have Government-wide oversight authority, we can look at wasteful spending with independence and a fresh

perspective. As we hold hearings in this committee, there will be no sacred cows.

The crop insurance industry is a well financed and influential lobby, but in this committee, there will be no free passes. Our responsibility is to look out for the taxpayer, not the crop insurers, drug companies, Federal contractors, or any other special interest.

I am not an agriculture expert. I grew up over my family's grocery store, so I know a little bit more about selling produce than I know about growing it. But I know a waste of taxpayers' money when I see it. What our committee will learn today is that the object of this hearing, the Federal Crop Insurance Program, is costing taxpayers billions of dollars.

Nobody can argue with the goals of the crop insurance program: to provide farmers and ranchers with a safety net when bad weather or bad luck threatens financial ruin. But from the taxpayer perspective, it is hard to imagine a more costly and inefficient way of providing this safety net for farmers.

The Federal Crop Insurance Program has become a textbook example of waste, fraud and abuse in Federal spending. Under this program, farmers received $10.5 billion over the last 6 years, but it has cost the taxpayers almost $19 billion to provide this financial protection to farmers. Over $8 billion in taxpayer funds have been used for excess payments to insurers and other middlemen. Somehow, about 40 cents of every dollar that the taxpayers have put into the crop insurance program has been for unproductive expenses.

The testimony from the Government Accountability Office will explain where some of this money is going. GAO has found that the private crop insurance companies are obtaining underwriting profits that are almost three times as high as industry averages. These exorbitant profits are funded by the taxpayers and farmers that pay for the program. According to GAO, over the last decade, these crop insurance companies have earned $2.8 billion in underwriting profits. Simply reducing their underwriting profits to industry average levels would have saved the taxpayers almost $2 billion.

These reports of billions of dollars in taxpayers' expenditures are the reason I am holding this hearing today. Nobody begrudges assistance to a farmer whose crop is destroyed in a natural disaster, but no one should tolerate insurance companies that skim billions from the treasury to fatten their profits.

Eliminating waste, fraud and abuse is not a partisan issue, and on this committee we are particularly fortunate that Tom Davis is our ranking member, and that we have Democrats and Republicans who share the commitment to putting the interests of the taxpayers first, and understand the importance of our oversight role.

I am pleased that we are holding this hearing. It is not one of the usual ones. We don't have a bank of cameras. We don't have C–SPAN. We don't have all the other press covering our every move. But I think this can be as significant a hearing as any other, if we can explore ways to save the taxpayers what could amount to billions of dollars. I think there can be no more important purpose for an oversight committee.

[The prepared statement of Chairman Henry A. Waxman follows:]

**Statement of Rep. Henry A. Waxman, Chairman**
**Committee on Oversight and Government Reform**
**Waste, Fraud, and Abuse in the Federal Crop Insurance Program**

**May 3, 2007**

Our Committee started this year with four days of hearings on waste, fraud, and abuse. We examined why $12 billion in cash disappeared in Iraq. We looked at the problems created by our government's growing reliance on private security contractors. And we investigated the calamitous "Deepwater" contract to build ships for the Coast Guard.

We also held a day of hearings on waste, fraud, and abuse in the health care system.

This is a theme that we will return to repeatedly this year. The taxpayers understand that it costs money to run the government. But they can't accept rampant waste, fraud, and abuse that squanders their money on boondoggle programs. They are looking to Congress to rein in the wasteful spending and federal giveaways that are driving our nation deeper into debt.

Our Committee is uniquely positioned to weed out waste, fraud, and abuse. Because we have government-wide oversight authority, we can look at wasteful spending with independence and a fresh perspective.

As we hold hearings in this Committee on waste, fraud, and abuse, there will be no sacred cows.

The crop insurance industry is a well-financed and influential lobby. But in this Committee, there will be no free passes. Our responsibility is to look out for the taxpayer — not the crop insurers, the drug companies, the federal contractors, or any other special interest.

I'm not an agriculture expert. I grew up over my family's grocery store, so I know more about selling produce than I do about growing it. But I know a waste of taxpayer money when I see it. And what our Committee will learn today is that the subject of this hearing — the federal crop insurance program — is costing taxpayers billions of dollars in waste, fraud, and abuse.

Nobody can argue with the goals of the crop insurance program: to provide farmers and ranchers with a safety net when bad weather or bad luck threatens financial ruin. But from the taxpayer perspective, it's hard to imagine a more costly and inefficient way of providing this safety net for farmers.

The federal crop insurance program has become a textbook example of waste, fraud, and abuse in federal spending.

Under the crop insurance program, farmers have received $10.5 billion over the last six years. But it has cost the taxpayers almost $19 billion to provide this financial protection to farmers. Over $8 billion in taxpayer funds have been squandered in excess payments to insurers and other middlemen. Somehow, about forty cents of every dollar that taxpayers have put into the crop insurance program has gone up in smoke.

The testimony from the Government Accountability Office will explain where some of this money is going. GAO has found that the private crop insurance companies are obtaining

underwriting profits that are almost three times as high as industry averages. These exorbitant profits are funded by the taxpayers and farmers that pay for the program. According to GAO, over the last decade these crop insurance companies have earned $2.8 billion in underwriting profits. Simply reducing their underwriting profits to industry average levels would have saved taxpayers almost $2 billion.

These reports of billions of dollars in taxpayer waste are the reason I'm holding this hearing today. Nobody begrudges assistance to a farmer whose crop is destroyed in a natural disaster. But no one should tolerate insurance companies that skim billions from the Treasury to fatten their profits.

When I took over as chairman of this Committee, I made a commitment to the taxpayer. Finding waste, fraud, and abuse in federal programs will be our priority. Our goal is to make sure every taxpayer dollar is spent wisely and responsibly.

By exposing wasteful spending in programs like the federal crop insurance system, we can take the first step toward true reform.

Eliminating waste, fraud, and abuse is not a partisan issue. And on this Committee, we are particularly fortunate that Tom Davis is our Ranking Member. He shares my commitment to putting the interests of the taxpayer first and understands the importance of our oversight role.

I now yield to Mr. Davis for his statement.

Mr. Davis.

Mr. DAVIS OF VIRGINIA. Thank you, Mr. Chairman.

I guess we are really down in the weeds on this one today. I want to thank you for convening this hearing. As the principal House oversight committee, we are empowered by our rules to review and study on a continuing basis the operation of Government activities at all levels with a view to determining their economy and efficiency. That is a broad mandate to look anywhere in any department or agency for profligate spending and direct reforms.

This morning, we are going to focus that powerful oversight microscope on a costly program that seems uniquely and dangerously vulnerable to waste, fraud and abuse, the Federal Crop Insurance Program. In an attempt to induce the private insurance marketplace to underwrite the highly variable risks of crop blights and failures, the program subsidizes premiums and provides insurers with a generous margin to cover administrative and operating costs. The Federal Government even assumes a substantial portion of the liabilities flowing from the riskiest pool of policies.

But the program has not achieved its primary goal, to reduce or eliminate the need for annual disaster payments to farmers. In its current structure, the crop insurance system offers almost no incentives to limits costs, but practically invites unnecessary or fraudulent payments.

Today, we will hear from the Department of Agriculture, the USDA Inspector General's Office, the U.S. Government Accountability Office, and respected academics on efforts to control a subsidy program that last year cost taxpayers $2.5 billion.

Both the Inspector General and the GAO have made recommendations to the Agriculture Department's Risk Management Agency to tighten expenditure controls, recoup excessive payments, prevent fraudulent claims, and strengthen enforcement against those who exploit the program. We need to know what progress is being made implementing those recommendations; what resources are being applied to the task; and what is still to be done to reduce vulnerabilities.

Farm bills now under consideration may attempt to expand crop insurance availability and subsidies further still, so the inclusion of stronger fiscal controls and enforcement tools should be an urgent priority. The administration has proposed three important structural reforms to make crop insurance a more effective hedge against annual disaster payments, reduce administrative and operating costs, and limit underwriting gains by insurers in years when premiums far exceed paid claims.

Not surprisingly, some farm groups oppose these proposals, but as we have demonstrated in the past, bipartisan oversight by this committee can inform and improve the work of other committees trying to balance the needs and demands of various constituencies. In 2003 and 2004, our investigations, a very bipartisan investigation in fact, suggested by Mr. Waxman, of inspections and testing to detect mad cow disease brought important information to light about delays, denials and other lapses in vigilance that might have otherwise been overlooked.

With this hearing, we can shine the same curative light on the crop insurance program.

Again, Chairman Waxman, thank you for focusing the committee's attention on this important Federal program. I look forward to the testimony of today's witnesses and to our continued bipartisan work to make Government more efficient and effective.

[The prepared statement of Hon. Tom Davis follows:]

HENRY A. WAXMAN, CALIFORNIA
CHAIRMAN

TOM DAVIS, VIRGINIA
RANKING MINORITY MEMBER

ONE HUNDRED TENTH CONGRESS

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**Statement of Rep. Tom Davis**
**Ranking Republican Member**
**Committee on Oversight and Government Reform**
***"Waste, Fraud, and Abuse in the Federal Crop Insurance Program"***
**May 3, 2007**

Good morning and thank you for convening this hearing, Mr. Chairman. As the principal House oversight committee, we are empowered by our rules to "review and study on a continuing basis the operation of Government activities at all levels with a view to determining their economy and efficiency." That's a broad mandate to look anywhere, in any Department or agency, for profligate spending and to recommend reforms. This morning we focus that powerful oversight microscope on a costly program that seems uniquely and dangerously vulnerable to waste, abuse and fraud – the Federal Crop Insurance Program.

In an attempt to induce the private insurance marketplace to underwrite the highly variable risks of crop blights and failures, the program subsidizes premiums and provides insurers with a generous margin to cover administrative and operating costs. The federal government even assumes a substantial portion of the liabilities flowing from the riskiest pooled policies. But the program has not achieved its primary goal – to reduce or eliminate the need for annual disaster payments to farmers. And, as currently structured, the crop insurance system offers almost no incentives to limit costs, but practically invites unnecessary or fraudulent payments.

Today, we'll hear from the Department of Agriculture, the USDA Inspector General's office, the U.S. Government Accountability Office, and respected academics on efforts to control a subsidy program that last year cost taxpayers $2.5 billion. Both the Inspector General and the GAO have made recommendations to the Agriculture Department's Risk Management Agency to tighten expenditure controls, recoup excessive payments, prevent fraudulent claims, and strengthen enforcement against those who exploit the program. We need to know what progress is being made implementing those recommendations, what resources are being applied to the task, and what still needs to be done to reduce vulnerabilities.

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But, as we have demonstrated in the past, bipartisan oversight by this Committee can inform and improve the work of other Committees trying to balance the needs and demands of various constituencies. In 2003 and 2004, our investigation of inspections and testing to detect Mad Cow Disease brought important information to light about delays, denials and other lapses in vigilance that might have otherwise been overlooked. With this hearing, we can shine the same curative light on the crop insurance program.

Again, Chairman Waxman, thank you for focusing the Committee's attention on this important federal program. I look forward to the testimony of today's witnesses and to our continuing bipartisan work to make government more efficient and effective.

Chairman WAXMAN. Thank you very much, Mr. Davis.

If any Member wishes to insert an opening statement in the record, the record will be held open for 5 days for that purpose.

I do want to recognize Mr. Cooper, if you have any opening comments?

Mr. COOPER. Thank you, Mr. Chairman.

I would just congratulate you for holding this important hearing. Despite the lack of cameras, this is a top taxpayer issue. I congratulate you for focusing on this. Thank you.

Chairman WAXMAN. Thank you.

Mr. Braley, I know that you have a conflict in your schedule. I want to recognize you at this time for any comments you wanted to make.

Mr. BRALEY. Thank you, Mr. Chairman.

I want to thank you and the Committee on Oversight and Government Reform, particularly you and Ranking Member Davis for holding this hearing today to examine waste, fraud and abuse in the Federal Crop Insurance Program.

My high school math teacher in Brooklyn, IA was a Federal crop insurance adjuster during the summer time when he wasn't teaching math, so this is something that I have some familiarity with. I hope that the hearing will lead to improvements in the Federal Crop Insurance Program which will provide more benefits to farmers at lower cost, and which will provide savings to American taxpayers.

It is my distinct privilege to welcome today Dr. Bruce Babcock to our hearing. Dr. Babcock is a professor of economics and the director for the Center for Agricultural and Rural Development at Iowa State University, my alma mater. He will be testifying as part of the second panel of witnesses.

As a proud graduate of Iowa State, one of the premier agricultural institutions in the country, and I might add, the birthplace of the digital computer, I am proud to see leadership from Dr. Babcock and my alma mater on this important topic.

The Center for Agricultural and Rural Development at Iowa State University was founded in 1958 and conducts innovative public policy and economic research on agricultural, environmental and food issues. Under the leadership of Dr. Babcock, the Center's academic research and public outreach programs inform and benefit State, Federal and international policymakers; academic researchers; agricultural, food and environmental groups; American farmers; and the public.

Dr. Babcock has been a professor at Iowa State University since 1990. As the director for the Center for Agricultural and Rural Development, he has initiated advanced research on policies affecting valuation and risk management; Government price support and disaster relief programs; and agricultural insurance and alternatives.

His research has led to innovative risk management strategies for farmers and has led to the development of several new crop insurance products. I am very proud of the fact that in 2002, Dr. Babcock was awarded the USDA Secretary of Agriculture Award for outstanding accomplishments in the area of agricultural public policy research and formulation.

I would like to thank him for his leadership on this issue and for being here today. As the chairman mentioned, I cannot be here for the entirety of the hearing due to a scheduling conflict because, Dr. Babcock, I have another hearing on the impact of renewable energy production in rural America. So I hope you take that back with my regrets to the people at Iowa State.

However, I do look forward to reviewing your testimony, along with the testimony of all the other witnesses, so that we can learn about how improvements can be made to this very important Federal Crop Insurance Program to benefit America's farmers and taxpayers.

Thank you, Mr. Chairman.

Chairman WAXMAN. Thank you very much, Mr. Braley. We will look forward to hearing from Dr. Babcock in the next panel. We are pleased that he is here.

We are pleased to welcome the first panel of witnesses. We have three witnesses on our panel today. Mr. Eldon Gould is the Administrator of the USDA's Risk Management Agency. Mr. Gould has served as RMA Administrator since November 2005.

Michael Hand, the Risk Management Agency's Deputy Administrator for Compliance will also be joining Mr. Gould at the witness table.

Also joining us as a witness will be Phyllis Fong, the USDA's Inspector General.

Rounding out our panel will be Lisa Shames, GAO's Acting Director for Natural Resources and the Environment.

We welcome you all to our hearing today. It is the practice of this committee to swear in all witnesses, so we are not singling you out, and we would like you if you would rise and please take the oath.

[Witnesses sworn.]

Chairman WAXMAN. Thank you very much. The record will indicate that each of the witnesses answered in the affirmative.

Mr. Gould, why don't we start with you? There is a button on the base of the mic. Push it in and pull it close enough to you so that we can hear it and it can also be heard for the record.

**STATEMENTS OF ELDON GOULD, ADMINISTRATOR, RISK MANAGEMENT AGENCY, U.S. DEPARTMENT OF AGRICULTURE, ACCOMPANIED BY MICHAEL HAND, DEPUTY ADMINISTRATOR FOR COMPLIANCE, RISK MANAGEMENT AGENCY; PHYLLIS K. FONG, INSPECTOR GENERAL, U.S. DEPARTMENT OF AGRICULTURE; AND LISA SHAMES, ACTING DIRECTOR, NATURAL RESOURCES AND ENVIRONMENT, U.S. GOVERNMENT ACCOUNTABILITY OFFICE**

**STATEMENT OF ELDON GOULD**

Mr. GOULD. Thank you, Mr. Chairman, and members of the committee. I am Eldon Gould, Administrator of the USDA Risk Management Agency. I am also a lifelong farmer from King County, IL, with a 1,500 acre corn, soybean and wheat farm, and a 700 sow farrow to wean hog operation.

I appreciate this opportunity to provide an update on the efforts of the RMA to improve the integrity of the Federal Crop Insurance Program. The Federal Crop Insurance Program is a partnership be-

tween the Federal Government and 16 approved insurance companies which deliver the insurance against crop failure due to natural causes for over 80 percent of America's farm acreage.

The program is working as it was intended and is performing well, meeting the targeted loss ratios set by Congress. We still have work to do and improvements to make, but we are making good progress in our fight against program abuse.

It bears saying that the vast majority of people in the Federal Crop Insurance Programs, farmers, insurance agents, loss adjusters, industry professionals and Government employees, are hard-working men and women acting with the highest integrity and competence.

That being said, we are committed to doing all we can to enhance and maintain program compliance through prevention, detention and enforcement. We recognize that with the increased workload required of our compliance people in the wake of the Agriculture Risk Protection Act, we have to work efficiently. RMA's compliance program emphasizes preemption and deterrence in our efforts, while still aggressively pursuing program abuse by assisting USDA's Office of Inspector General and the Department of Justice.

The results from our data mining efforts have made an impressive difference in avoiding undue payments to people who might try to take advantage of this important program. Data mining alone has achieved reductions and indemnities for the selected producers of more than $437 million since the 2002 crop year.

We also now use remote sensing, geospatial information technologies, and other computer-based resources to ensure we are being good stewards of the taxpayer dollar.

Our compliance personnel completed the second year of a structured random policies review in 2006, and will soon begin the third round of the 3-year cycle of reviewing participating insurance providers. Compliance completes the random reviews to establish a program error rate under the Improper Payments Information Act of 2002. It is noteworthy that our main observed error rate from these reviews on 600 randomly selected policies was 2.64 percent.

Mr. Chairman, I have here the administration's 2007 farm bill proposal and I would like to submit it for the record. The farm bill proposes redirecting $10 million of existing funds authorized under the Federal Crop Insurance Act to increase compliance personnel and training and expand the very effective tools that we use. The funds requested would also support data mining efforts through the continued development of our comprehensive information management system [CIMS]. Our current outdated business systems are at the end of their expected life cycle, making it impossible to make comparisons across crop years electronically.

We desperately need new IT resources to put the wealth of information we gather to the best use. The data warehouse itself, which consolidates the information from all of these data bases, and is used to support the data mining efforts, must be replaced.

In our 2008 budget, we have asked for $5.4 million to replace equipment, and $3.6 million to continue the regular operations of data mining. We also ask for approved insurance providers to share in the cost to develop and maintain a new IT system by assessing a one-half cent per dollar of premiums sold.

Administration of the crop insurance program requires all interested parties to identify viable insurance products and solutions that meet the needs of the agricultural community. Working together, we will continue to maintain program integrity through prevention, detention and enforcement.

I thank you for this opportunity to participate in this important hearing, and I look forward to responding to questions on these issues.

[The prepared statement of Mr. Gould follows:]

Statement by Eldon Gould
Administrator
Risk Management Agency
United States Department of Agriculture
Before the House Committee on Oversight and Government Reform
May 3, 2007

Mr. Chairman and members of the Committee, I am Eldon Gould, Administrator of USDA's Risk Management Agency (RMA). I am also a life-long farmer in northern Illinois who values access to a crop insurance program that is administered to ensure program integrity and the best use of the taxpayer dollars.

I appreciate the opportunity to provide an update on the efforts of RMA to continue to improve the integrity of the Federal crop insurance program. Any discussion of program integrity must include an update on our successes and challenges in implementing the Agricultural Risk Protection Act of 2000 (ARPA). In fulfillment of the mandates of ARPA, and under the direction of the Federal Crop Insurance Corporation (FCIC) Board of Directors (Board), RMA continues to promote an aggressive agenda to bring new and innovative insurance products to the agricultural community, to maintain and improve our current insurance products, to ensure outreach to small and limited resource farmers, to promote equity in risk sharing and to guard against fraud, waste and abuse within the program.

The Federal crop insurance program has experienced extraordinary growth in the last quarter century. In crop year 2006, through the private sector delivery system, RMA provided $49.9 billion of protection to farmers on approximately 370 commodities, covering nearly 80 percent of major crops for which we can determine total eligible acres within the United States. This coverage was offered through 21 plans of insurance and approximately 1.1 million policies insuring about 242 million acres. In 2005, crop insurance provided approximately $2.4 billion in indemnity payments to farmers and ranchers. For 2006, indemnity payments to farmers totaled approximately $3.4 billion. We estimate that in 2007, we will reach $65 billion in insurance protection for American agriculture.

The Federal crop insurance program is working as it was intended and it is performing well, meeting the targeted loss ratios. That is not to say that more cannot be done, especially with regard to reducing program fraud, waste and abuse. More can, should and must be done. RMA is responsible to the American taxpayer and works diligently to be a good steward of the tax dollar. America's farmers and taxpayers deserve a flexible, fair and fraud-free program. Program integrity is maintained through prevention, detection and enforcement.

RMA's efforts to maintain program integrity within the Federal crop insurance program are comprised of numerous activities and initiatives: Quality Control and Assurance, Data Mining, Sanctions and Enforcement, IT System Improvements, Conflicts of Interest Guidelines and Program Simplification.

RMA is continually seeking new and more effective ways to work with the other regulatory bodies and government agencies as well as AIPs, agents and producers to ensure the integrity of the Federal crop insurance program. RMA compliance reviews continue to reveal that there are only a small number of producers who have been involved in fraud or illicit activity. While no level of criminal or abusive behavior is acceptable, RMA continues to believe the number of persons involved in criminal activity is relatively small.

Because they share in risk, the approved insurance providers (AIPs) have a stake in working with us to prevent fraud, waste and abuse. We have worked closely with them to strengthen program integrity, protect taxpayer dollars, and better assure that those who deliberately break the rules are caught and punished. The vast majority of people in the Federal crop insurance program -- farmers, insurance agents, loss adjustors, industry professionals and government employees-- are honest, hard-working men and women acting with the highest integrity and competence.

**Emphasizing Prevention through Better Quality Control and Assurance**

**Program Integrity**

RMA's Compliance function workload increased substantially due to the expansion of the Federal crop insurance program and the implementation of ARPA. In order to address the increases, RMA is emphasizing preemption through better quality control and assurance, while still aggressively pursuing program abuse by assisting USDA's Office of Inspector General (OIG) and the Department of Justice. Improvements in quality controls and investigations continue to be assisted by new and better technology, specifically the use of data mining, remote sensing, geospatial information technologies and other computer-based resources.

The renegotiation of the 2005 Standard Reinsurance Agreement (SRA) resulted in changes in the way RMA ensures program compliance. The SRA directs insurance providers to expend more resources on quality assurance and internal controls than ever before. The new SRA also recognizes that insurance providers have improved internal control processes in response to requirements of the Sarbanes-Oxley Act. The SRA permits the insurance providers to document and receive credit for their efforts rather than complying with a separate set of assurance mandates.

In conjunction with the new quality control requirements, RMA Compliance has revised its work plans to reflect a more balanced approach between quality assurance and investigating program abuses. In a time of declining resources and increased responsibilities, effective internal controls provide a significant cost-benefit compared to identifying and prosecuting program abuse alone. RMA is currently reviewing company operations and internal controls to determine if their efforts actually address crop insurance program vulnerability concerns.

RMA Compliance personnel completed the second year of structured random policy reviews in 2006, and will soon begin the third round in the three-year cycle of reviewing participating insurance providers. Compliance completes the random reviews, in conjunction with an assessment of each insurance provider's operational compliance, and uses the information to establish a program error rate under the Improper Payments Information Act of 2002 (IPIA). It is noteworthy that RMA's observed error rate from reviews on 600 randomly selected policies was 2.64%. RMA initially projected 5.0% on the first IPIA reports, so this number is less than

expected. We would also note that the Administration requested funding for additional Compliance resources in each of the past three budget cycles, mainly for the purpose of fully staffing the work to determine the program error rate in accordance with the IPIA.

The Government Accountability Office (GAO) audited RMA compliance activities in 2005, and recommended areas for improving our compliance efforts. The GAO made several recommendations that RMA accepted and is working to implement.

Compliance managers continue to concentrate on the mission-critical tasks of evaluating and improving new processes to prevent and deter fraud, waste and abuse in the crop insurance program. We have dedicated significant resources to building and adapting a reporting and tracking system to complement and integrate the oversight mandates established by ARPA and other statutory requirements.

While RMA, FSA and the insurance providers have preempted tens of millions of dollars of improper payments through these and other measures, RMA is constantly identifying ways to balance competing needs to make our products fraud-proof while seeking to provide responsive, useful risk protection to farmers. We still have work to do and improvements to make, but we are making good progress in our fight against program abuse.

**Detection via Data Mining**

RMA is making significant progress in preventing fraud, waste and abuse through the expanded use of data mining. As part of the ARPA legislation, data warehousing and data mining techniques were explicitly identified as tools to be used by RMA to strengthen the crop insurance program's oversight efforts. RMA contracts with the Center for Agribusiness Excellence (CAE) at Tarleton State University to develop these technologies. Since employing these technologies in 2001, RMA has achieved substantial program savings through proactive efforts to identify program vulnerabilities and abuse.

RMA has preempted millions of dollars' worth of expected payments and RMA continues to identify ways to reduce program abuse. RMA continues to use data mining to identify anomalous producer, adjuster, and agent program results and, with the assistance of Farm Service Agency (FSA) offices, conducts growing season spot checks to ensure that new claims for losses are legitimate. These spot checks based on data mining have resulted in a significant reduction in anomalous claims for certain situations. Specifically, reduced indemnities on spot-checked policies were approximately $112 million in 2002, $82 million for 2003, $71 million in 2004, $138 million in 2005, and $35 million in 2006. We are optimistic about the long-term benefits of data mining in our compliance efforts and elsewhere.

As noted above, the annual spot check list combines the strengths of data mining technologies and the farm-level knowledge of FSA, to identify and monitor those producers whose crop insurance losses are not consistent with those of their neighbors. This effort alone has achieved reductions from prior year indemnities for the producers selected of more than $437 million dollars since the 2002 crop year. More importantly, these reductions are achieved without RMA or FSA having to issue administrative sanctions or engage in lengthy and costly criminal investigations to curb program abuse. These reductions represent more than a $20 return for

every dollar spent by RMA on data mining since its inception. Our analysis shows that this change in claims behavior for most producers persists for several years, resulting in overall program savings that are even higher over a longer-term period

Data mining findings also demonstrated that the considerable majority of producers participating in the crop insurance program used the risk management tools we offer exactly as they were intended. CAE, using an analysis technique known as a decision tree, classified the entire crop insurance book of business into a range of behavior, from those producers who almost never had losses to those who had frequent and severe losses. Through this method, CAE was able to demonstrate that most producers used the risk management tools as intended and only a small percentage of producers exhibited behavior that warranted future review.

In addition, CAE conducts internal data mining research for RMA to assist compliance and underwriting efforts and any other research deemed necessary by the agency to improve the effectiveness and efficiency of the crop insurance program. CAE currently produces approximately 160 such research products per year for RMA, including products such as crop simulation models, planting date studies and methods for correctly identifying high-risk land.

RMA also uses data mining to verify compliance with established rules and regulations. For example, data mining identified policies where a comparison of past claims and production data indicated that AIPs had often failed to use claim production data to establish future approved yields, as required by regulation. RMA is providing this information to the AIPs to assist them in correcting producer data when such errors are found.

Outside audit bodies such as the USDA's OIG and the General Accountability Office (GAO) have also recognized our success with the use of data warehousing and data mining technologies. OIG recommended that USDA employ data mining in other farm programs. Further, both OIG and GAO have been customers, using CAE on occasion to assist them with audits of farm programs.

The benefits from using data warehousing and data mining technologies have increased every year since its inception. RMA expects the benefits generated from using these technologies to continue and plans to expand its use of data mining technologies to all areas of the program in the near future.

The 2008 Budget includes a proposal that would expand the uses of mandatory ARPA research and development funding for data mining as well as for Comprehensive Information Management System (CIMS). Specifically the FY 2008 President's Budget would authorize the use of $5.4 million for replacement of equipment and $3.6 million to continue regular operations of data mining.

**Enforcement**

RMA continues to make progress in the Administrative Sanctions arena. In 2005, RMA imposed 24 sanctions, such as suspensions, debarments, and disqualifications on producers, agents and loss adjusters found to have violated approved policies and procedures. For 2006, RMA

imposed 41 sanctions and had 53 additional sanctions pending at the end of the year. RMA also routinely publishes the Department of Justice press releases regarding successful prosecutions of crop insurance program abuse on our website as a reminder to program participants that maintaining integrity is critical.

We are improving the timing and quality of our sanctions requests as well. RMA continues to work with USDA's Office of General Counsel (OGC) to limit the number of cases declined due to insufficient evidence. This improvement is attributable to Compliance personnel becoming more proficient at identifying evidence and establishing cases that will pass legal sufficiency requirements.

Finally, modifications to the Administrative Sanctions regulations that were identified by GAO as requiring publication are in clearance. These regulations will formalize all the sanctions authority Congress provided RMA in ARPA.

In 2005, GAO audited RMA's overall compliance activities, and recommended areas for improving our compliance efforts. GAO made several recommendations that RMA accepted and is working to implement. However, data mining remains central to our compliance efforts because it is cost efficient and cost effective.

Within current resources, compliance managers also continue to concentrate on the mission-critical tasks of evaluating and improving new processes to prevent and deter fraud, waste and abuse in the crop insurance program. We have dedicated significant resources to building and adapting a reporting and tracking system to complement and integrate the oversight mandates established by ARPA.

While RMA, FSA and the AIPs have prevented tens of millions of dollars of improper payments through these and other measures, RMA is constantly identifying ways to balance competing needs to make our products fraud-proof while seeking to provide responsive, useful risk protection to farmers. We still have work to do and improvements to make, but we are making good progress in our fight against program abuse.

**IT System Improvements**

A critical area in program integrity improvement is enhancing the capability of RMA's IT system. ARPA also instituted new data reconciliation, data mining and other anti-fraud, waste and abuse activities that require the data to be used in a variety of new ways. The current IT system was not designed to handle these types of data operations. Consequently, the data must be stored in multiple databases, which increases data storage costs and processing times, and increases the risk of data errors.

The 2008 Budget includes two proposals that will facilitate funding of our IT needs.

The first is similar to last year's request, which required insurance providers to share in the cost to develop and maintain a new IT system. Insurance providers would be assessed a fee based on one-half cent per dollar of premium sold. The fee is estimated to generate an amount not to exceed $15 million annually. After the new IT system has been developed, the assessment

would be shifted to maintenance and would be expected to reduce the annual appropriation of the salaries and expenses account of RMA.

The second, as noted earlier,would expand the uses of mandatory ARPA research and development funding for data mining and data warehousing activities required by ARPA, and the testing and development of the Comprehensive Information Management System.

**Conflict of Interest Supplementary Guidance**

RMA recognizes that certain types of interactions between agents, loss adjusters and policyholders pose serious conflict of interest challenges to the integrity of the crop insurance program. RMA investigations and independent audits by OIG and GAO have identified instances where crop insurance claims have been influenced by such conflicts.

The 2005 SRA contained new and enhanced provisions that strengthened RMA's ability to prevent and detect those conflicts of interest that might adversely affect program integrity. Specifically, the SRA strengthened provisions that 1) prohibited certain conduct by agents during the loss adjustment process, and 2) required increased conflict of interest disclosure by agents, loss adjusters and AIP employees.

To assist the AIPs in implementing new SRA provisions dealing with prohibited activities of agents during loss adjustment, RMA worked closely with AIPs and agents to develop a comprehensive guidance document that reflected tough but workable standards. RMA issued the resulting Managers Bulletin in October 2005. The reaction of the crop insurance industry, agent associations and oversight bodies has generally been very positive to these standards.

After addressing this first area of concern, RMA has now turned to the problem of developing guidance on conflict of interest disclosure. The SRA requires that all AIP employees and affiliates disclose any potential conflicts of interest to the AIPs and, in turn, to RMA. Such disclosure is used to determine what conduct may be prohibited and what reviews must be done by the AIP. RMA has listened to the comments of the industry regarding conflict of interest disclosure to ensure that guidance will contain a workable standard that will be consistent across all AIPs and will provide important information for RMA's data mining efforts.

RMA is now finalizing a Manager's Bulletin that contains further guidance to assist insurance providers in implementing changes to the SRA regarding conflict of interest disclosure. The Bulletin will establish standards for reporting conflicts of interest by insurance provider employees, agents, and loss adjusters. It will thereby promote program integrity and ensure adequate internal controls based on the identification of certain conflict of interest problems in past audits and investigations of fraud, waste and abuse in the program.

**Simplification of the Federal Crop Insurance Program**

Simplification of the program is a priority of both RMA and the FCIC Board. As new programs have been added, more complexities have arisen.

As an initial priority, RMA is developing a combination policy, which combines the existing Actual Production History, Crop Revenue Coverage, Income Protection, Indexed Income Protection and Revenue Assurance plans of insurance into one consolidated insurance plan (Combo). We have been working on this for some time now, and the draft final rule is being completed and targeted for OGC review and approval during May 2007. The final rule is intended to be effective for the 2009 crop year, with publication slated for late 2007. We believe this change will provide producers a broader array of insurance options in a more straightforward process and improve product delivery and operations.

RMA is also working closely with FSA to simplify our joint reporting requirements. The two agencies have so many issues and requirements in common and we interact so frequently that it makes great sense for us to work together to ease the reporting burden on the farmer and on the agencies. Our objective is to vastly improve the reporting accuracy between the companies and FSA.

RMA is actively working on the second phase of a project to implement section 10706 of the 2002 Farm Bill to assist the Secretary of Agriculture in developing a Comprehensive Information Management System (CIMS), which will simplify and improve the programs administered by RMA and FSA. This project will provide an information system that allows RMA, FSA other USDA entities and AIPs to process, share and report on approved common information. The second phase of the project focuses on the sharing and analysis of existing RMA and FSA producer and acreage data. Recommendations have been provided to both RMA and FSA for subject matter experts to review elements for producers, land locations, crops and acreage reporting.

The common component of CIMS has been operational internally since July 2006. It is being loaded weekly with over 141 million producer and acreage records from RMA and FSA for 2005, 2006 and 2007. This data is processed and is electronically available to approved RMA and FSA users to provide participation summary reports, information on individual producers and discrepancies in reported acreage. Once RMA's and FSA's System of Records have been updated for CIMS, the reinsured companies will have electronic access to their insured producers information only. All data is secure and subject to controls to prevent unauthorized access.

In March 2006, a 'Notification Area' was added to the CIMS web interface to allow FSA County Offices and AIPs to communicate on data issues identified by CIMS.

**Conclusion**

Administration of the crop insurance program requires all interested parties working together to identify viable insurance products and solutions that meet the needs of the agricultural community. Moreover, if the program is to continue to be successful, the resources to provide the checks and balances necessary to guard against the risks of fraud, waste and abuse need more focus and priority.

RMA continues to improve and update the terms and conditions of existing crop insurance policies to enhance coverage and efficacy of the policies, as well as to clarify and define

insurance protection and the duties and responsibilities of the policyholder and AIPs to improve the understanding, use and integrity of the program.

When I accepted this position, Secretary Johanns charged me with administering the crop insurance program in a timely, responsible, and farmer-friendly manner. I will work with the insurance companies, agents' groups, producer groups and, of course, the Congress, to meet our common goals of providing effective insurance products, processing timely and accurate claims when losses occur and identifying and eliminating fraud, waste and abuse in the program to the greatest extent possible. Thank you all for the support provided by the Committee to help improve program integrity within the Federal crop insurance program. We have much to be proud of and much to look forward to in continuing to work together.

Again, thank you for the opportunity to participate in this important hearing. I look forward to responding to questions on these issues.

Chairman WAXMAN. Thank you very much.

Let's now go to Ms. Fong.

**STATEMENT OF PHYLLIS K. FONG**

Ms. FONG. Thank you, Mr. Chairman, Ranking Member Davis and members of this committee. We appreciate the opportunity to be here today to testify about our views on the crop insurance program.

As you know, we in the IG have conducted substantial audit and investigative work pertaining to this program over the past few years. I just want to make a few key points for you today.

There has clearly been a significant upward trend in Federal payments to assured insurance providers or insurance companies for expenses in underwriting gains. Over the past 6 to 7 years, total payments to AIPs have increased to record levels. The Federal reimbursement to AIPs for each producer policy has increased almost 100 percent during that period of time, and the Government's subsidy of premiums has also increased by over 180 percent.

We believe that Congress has done a successful job in broadening the Federal safety net for producers, but it is now time to reassess what constitutes an acceptable cost to the Government.

We believe that to have an effective crop insurance program, we need to have three elements. First, we have to have the proper assignment of risk between insurance companies and the Government.

Second, we need to have effective management controls in place, including a strong quality control system.

And third, we need aggressive compliance reviews and investigations to address fraud.

Let me just say a few words about each of those elements. In terms of assignment of risk, we believe that currently RMA is underwriting most of the risk for crop losses. As a result, the insurance companies have less of an incentive to vigorously administer the Federal Crop Insurance Program in accordance with the Government's and taxpayers' best interests. To ensure that Federal funds are used responsibly and efficiently, AIPs need to consistently monitor risky policyholders. They need to deny claims of questionable losses, and they need to address weaknesses in their own practices.

With respect to the second element of management controls, we have reported our concerns on issues such as conflict of interest among sales agents, loss adjusters and policyholders. We believe this is an area that needs increased attention.

We also believe that a common information system between RMA and FSA is critical to improving integrity and reducing the risk of improper payments.

Third, we recognize that RMA has taken positive steps to improve the quality control system, but more can be done in this area.

With respect to enforcement, we in OIG work very closely with RMA and the Department of Justice to aggressively pursue fraudulent crop insurance claims and schemes. Compared to fraud affecting other USDA programs, these cases are particularly complex and time consuming. We find that we must expend a lot of resources to pursue them because the schemes are very complex.

Some of the kinds of fraud that we have seen include losses being claims on crops that were never planted. We have seen collusion between program participants to fabricate their losses. And we have seen fraudulent shifting of crop production between insured and non-insured parcels of land.

While many of the participants in the program are honest and comply with the program's requirements, there have been a few who have really given the crop insurance program a bad name, and we feel that we need to aggressively pursue those to ensure that there is an effective safety net for all producers.

In terms of recommendations, we support many of the provisions that the administration has included in its farm bill proposal, and we have also detailed other specific recommendations in my full written statement.

Thank you again for inviting me, and we look forward to answering questions.

[The prepared statement of Ms. Fong follows:]

UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL

**STATEMENT OF THE HONORABLE PHYLLIS K. FONG**

**INSPECTOR GENERAL**

Before the

COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM

U.S. HOUSE OF REPRESENTATIVES

May 3, 2007

Good morning, Chairman Waxman, Ranking Member Davis, and Members of the Committee. Thank you for inviting me to testify before you today to discuss the Office of Inspector General's (OIG) views on the Federal Crop Insurance Program. The crop insurance program represents a significant investment by the Department of Agriculture (USDA) and Congress in the Federal safety net for America's producers. OIG has conducted substantial audit and investigative work on the crop insurance program and its participants. As requested by the Committee, I will address issues of waste, fraud, and abuse in the crop insurance program. My testimony will also review some of our most significant findings and recommendations on the program's current costs, regulatory requirements, and areas of continuing concern.

## I. Introduction

Congress established the Federal crop insurance program in the 1930s as a safety net for American agricultural producers as they strove to recover from the Great Depression and the Dust Bowl. Over the years the program has gone through significant changes. The 1996 Farm Bill[1] created the Risk Management Agency (RMA) to provide supervision to the Federal Crop Insurance Corporation (FCIC) and have oversight of its insurance programs. FCIC is a wholly-owned Government corporation that publishes insurance regulations and manages the Federal crop insurance fund.

RMA administers the Federal crop insurance program through a joint effort with approved insurance providers (AIP) under the Standard Reinsurance Agreement (SRA), a cooperative financial assistance agreement allowing AIPs to sell and service Federal crop insurance program policies. Under the SRA, FCIC reinsures or subsidizes a portion of the losses and pays the AIPs an administrative fee–a predetermined percentage of premiums–to reimburse the AIPs for their administrative and operating expenses associated with selling, servicing, and adjusting crop insurance and subsequent claims.

[1] The Federal Agriculture Improvement and Reform Act of 1996, P.L. 104-127.

*The Agricultural Risk Protection Act of 2000*

In 2000, Congress passed the Agricultural Risk Protection Act (ARPA).[2] ARPA significantly expanded Federal crop insurance assistance for producers by increasing their access to more affordable insurance, enlarging the role of the private sector, and raising premium subsidies paid by the Government. Premium subsidies were expected to increase by $8.2 billion over 5 years to encourage more producers to participate and also purchase higher coverage levels. The Act enlarged the role of the private sector in the program by prohibiting RMA from conducting research and development for any new policies for agricultural commodities. Rather, the Act requires that new product development be accomplished through contracts with the private sector.

The impact of these ARPA provisions is demonstrated by two program statistics related to the period of 2000–2006: the number of acres insured increased from 206 million to 242 million—a 17 percent increase; and the total gross liability for all policies has increased from $34 billion to $55 billion—a 62 percent increase.

**II. The Increasing Federal Financial Responsibility**

The year before ARPA was enacted, OIG issued a report to the Department, entitled *Report to the Secretary on Federal Crop Insurance Reform,*[3] that brought together the major problems we identified in prior audits and investigations. We believe that many of the issues and concerns it presented remain timely and relevant to the program and today's hearing. In our report, OIG concluded that one of the underlying factors substantially contributing to the program losses and management problems we observed was RMA's policy of underwriting most of the risk for the crop losses. OIG believed–and we continue to believe–that by assigning low overall risk to the AIPs, the AIPs have less incentive to administer the insurance policies in accordance with the Government's and taxpayers' best interest. That is to say, incentives are lacking for AIPs to effectively

[2] The Agricultural Risk Protection Act of 2000, P.L. 106-224.
[3] Report To The Secretary On Federal Crop Insurance Reform, Revised as of April 19, 1999. OIG Report No. 05801-2-At.

monitor risky policyholders, deny claims of questionable losses, and address inadequacies in their own practices. We concluded that the structural framework of the program had increased the risk or vulnerability to fraud, waste, and abuse.

To demonstrate the impact of RMA's risk-sharing policies, we reported that more Federal dollars were going to AIPs than were paid to producers to cover insurable losses. From 1995 to 1998, producers received a total of $5.4 billion in indemnities, but because only $3.4 billion was covered by the producers' premium, the Government paid the remaining $2 billion to AIPs to cover the claims. AIPs also received, from the Government, a total of $2.8 billion for underwriting gains[4] and administrative and operating (A&O) expenses.

The upward trend in payments (A&O expenses and underwriting gains) to AIPs that OIG observed in 1999 continues today. From 2000 to 2006, total payments to AIPs for underwriting gains and A&O expenses have increased to record levels—from $834 million to $1.852 billion, an increase of 122 percent. Although RMA renegotiated the SRA in 2004 and included provisions to reduce the A&O subsidy rate, total reimbursement for A&O expenses has increased from $552 million to $958 million—a 73 percent increase.

This has resulted in almost a 100 percent increase in the Federal Government's reimbursement to A&Os for each producer policy—from $417 to $829. This increase is due to ARPA increasing the percentage share that the Government pays for most coverage levels of insurance and the fact that more producers opted for higher levels of coverage. (Commodity price increases may have further impacted this increase.) Additionally, total premiums paid during this period (2000-2006) increased from $2.5 billion to approximately $4.7 billion; thereby increasing the Government's subsidy[5] of

[4] An underwriting gain (loss) is the profit (deficit) that remains after paying claims and expenses. Insurers generate profits from underwriting and from investment income. Their chief business is insuring against risks for a profit, and one measure of success is whether there is money left after paying claims and expenses. This amount, if any, is their underwriting gain.

[5] The Government subsidizes a share of the producer's premium. ARPA increased the percentage share that the Government pays for most coverage levels of crop insurance, effective with the 2001 crop year. The Government's share significantly increases for all levels of coverage but declines as producers select

the premiums from $951 million to $2.680 billion—an increase of 182 percent. In 2000, the Government's subsidized share of total premium amounted to 37 percent; in 2006, it was 59 percent of total premium.

While ARPA has been successful at significantly broadening the safety net for producers, we believe that policymakers and program managers should reassess what constitutes an acceptable cost to the Government.

In addition to our observations regarding the crop insurance program's structure and assignment of risk to the AIPs, our report summarized a number of management control weaknesses we are still seeing today. These include conflicts of interest [6] among sales agents, loss adjusters, and/or policyholders; inadequate verification of losses and errors by the loss adjusters (who verify the losses reported by producers and determine the indemnity amounts owed); and inadequate or non-existent quality control processes by AIPs and RMA. OIG continues to focus on these issues of concern in our crop insurance program audits.

### III. Strengthening the Integrity of the Federal Crop Insurance Program

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As the Federal crop insurance program evolved, Congress has recognized the need to strengthen the program's integrity. While the passage of ARPA significantly expanded Federal crop insurance assistance to producers, Congress also included several mandates to improve program compliance and integrity. For example, ARPA requires annual reconciliation of all relevant producer information by RMA and the Farm Service Agency (FSA), authorizes the use of data mining as a new technology for targeting compliance reviews and investigations, and requires RMA to coordinate and work with FSA to monitor crop conditions throughout the growing season. RMA was also authorized to

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higher levels of coverage. After ARPA, the Government's share of the premium ranged from 67 percent at 50-percent coverage to 38 percent at 85-percent coverage.

[6] Business or other (familial) relationships that could encourage or prejudice independent and accurate reporting of data such as yields, acreage, and payments.

renegotiate the SRA's terms and conditions once during the 2001 through 2005 reinsurance years.

The 2002 Farm Bill[7] required the Secretary to develop a comprehensive information management system (CIMS) for RMA and FSA. Historically, RMA and FSA kept separate data about their program participants, even though the two agencies serve the same community of producers and some of their program data and payments are used to support producer eligibility for other program benefits. Congress recognized the value of reducing the waste associated with duplicative systems and simplifying the process for producers. Implementation of a common information system would help ensure consistency and accuracy of producer data and is, in our view, critical to improving integrity within farm programs and reducing risk of improper payments.

*Preventing Improper Crop Insurance Payments*

The identification and elimination of improper payments is a major Governmentwide initiative mandated by the Improper Payments Information Act of 2002 (IPIA).[8] All Federal agencies, including RMA, are required to find out where they are most susceptible to making significant improper payments, estimate the size of the problem, identify what caused the improper payments, and take action to prevent them.

OIG has monitored RMA's actions and progress in complying with these important mandates. In September 2003, OIG issued an audit report assessing the Department's actions to implement significant portions of ARPA.[9] We found that, to its credit, the Department had initiated reasonable actions to implement most of ARPA's significant provisions. However, the required annual reconciliation of all relevant RMA and FSA data was not accomplished. We recognized that there were significant barriers to implementing an effective reconciliation, including differences in RMA's and FSA's program definitions. For example, RMA allows the producer to subdivide his/her

[7] The Farm Security and Rural Investment Act of 2002, P.L. 107-171.
[8] The Improper Payments Information Act of 2002, P.L. 107-300.
[9] USDA Implementation of the Agricultural Risk Protection Act of 2000. Audit No. 50099-12-KC.

farming operation into separate units and to opt whether to have insurance coverage on each unit; FSA defines a farm unit as a total operational unit within a county and it issues payment to that unit.

We recommended that the Department re-engineer its data reporting for each producer, landowner, and policyholder under a single integrated comprehensive information system. In response, RMA stated that it intends to fulfill ARPA's requirements through its (and FSA's) current CIMS efforts. However, the recent timetable provided to us by RMA indicates that full implementation of CIMS is not expected until 2012. As a result, the mandated reconciliation of RMA and FSA data will not occur until that year or later. In the interim, we would recommend that Congress work with RMA and FSA to determine whether implementation of CIMS can be expedited or whether some other action can reasonably be taken to fulfill ARPA's mandate in this regard.

We are currently reviewing RMA's implementation of the IPIA. With the concurrence of the Office of Management and Budget (OMB), RMA has instituted an alternative to the process required by the IPIA. Due to its limited resources, RMA has developed a National Operations Review program that will review a sample of loss claims from AIPs on a 3-year cycle to establish an error rate for improper payments. Although OMB has approved RMA's approach, we are discussing with RMA our concerns that a statistically valid sampling method will not be used to select claims. Whether this process will be effective in fulfilling the goals and requirements of the IPIA may not be known for some time.

*The Standard Reinsurance Agreement: Preserving Federal Interests*

OIG monitored RMA's renegotiation of the SRA and offered RMA a number of suggestions to improve program integrity. We suggested that RMA include specific authority in the SRA that would allow the agency to establish a standard quality control review system by regulation, strengthen its conflict of interest provisions, strengthen the oversight and monitoring of large claims, and reduce administrative reimbursement rates.

We acknowledged and concurred with RMA's attempts to reduce the Government's share of the risk, the A&O reimbursement rate, and the amount of the premium AIPs could retain (underwriting gains).

Although RMA had some success in strengthening SRA provisions, much of what was unfavorable to the AIPs was modified during negotiations with the AIPs. Our report, *Renegotiation of the Standard Reinsurance Agreement,*[10] issued in January 2005, summarized our suggestions on ways RMA could strengthen program integrity, as well as some of the significant changes made to RMA's proposals after public comment. RMA was successful in strengthening program integrity by improving the conflict of interest provisions and oversight of adjusters; establishing its option to review large claims before payments are issued (loss claims in excess of $500,000); obtaining authority to have companies review policies under a quality control environment driven largely by data mining; and identifying anomalous financial behavior.[11] In its renegotiation of the 2005 SRA, and as required by ARPA, RMA established an entirely new process that requires AIPs to review policies identified as anomalous by RMA data mining. OIG will continue working to monitor and evaluate the effectiveness of RMA's efforts in these areas.

## IV. Weaknesses and Vulnerabilities Persist in the Federal Crop Insurance Program

*OIG Investigations of Fraud in the Crop Insurance Program*

The great majority of producers and private sector business entities that participate in the crop insurance program are, of course, honest and determined to properly comply with its requirements. The improper conduct of a minority of participants can tarnish perceptions of the program's value as part of the Federal safety net for producers. OIG continues to investigate fraud and other criminal activity in the crop insurance program across the

[10] Audit No. 05099-109-KC.
[11] For example, producers who have very large approved yields relative to their peers and large, multi-year claims.

United States. Since fiscal year 1999, our investigations have resulted in 69 indictments, 52 convictions, and over $54 million in monetary recoveries.

Our investigative work has shown these cases to be—compared to fraud affecting other USDA farm programs—particularly complex in their details and correspondingly time-consuming to investigate. Crop insurance cases frequently involve multiple subjects such as producers, landowners, sales agents, and insurance adjusters. It is not uncommon for individual crop insurance fraud cases to involve comparatively large amounts of monetary losses to USDA, sometimes reaching into the millions of dollars per producer. We continue to work with USDA and the U.S. Department of Justice to aggressively pursue fraudulent crop insurance schemes that undermine the program and burden taxpayers.

*Common Fraud Schemes*

OIG's investigation into potential criminal activity in the Federal crop insurance program has revealed a series of schemes that are used by some producers and business associates to defraud the program and improperly obtain crop insurance payments. Among the primary schemes we have observed are the following:

- Claiming losses on crops that were never planted or that were intentionally made to fail. (e.g., *responsible farming practices are intentionally not used, and the cause of the crop loss is inconsistent with other area producers.)*

- Agents and adjustors collude to manufacture losses. (e.g., *an adjuster moves with the agent from company to company.*)

- Creation of sham farming entities to illegally obtain crop insurance indemnity payments. (e.g., *setting up new entities or contracts to hide prior bad loss experiences.*)

- Concealing actual production of insured crops to receive higher indemnity payments. (e.g., *claiming crop losses when none have occurred.*)

- Falsely reporting planting dates to receive crop insurance payments. (e.g., *backdating forms in order to ensure that the producer's planting dates are within the planting dates approved by RMA.*)

- Shifting crops to create loss units, wherein a producer attributes production from one section of insured land to either a non-insured parcel of land or another non-loss unit.

*Major Investigations*

OIG crop insurance investigations have resulted in successful prosecutions and monetary recoveries from individuals engaged in each of the above schemes. I would like to present summary information to the Committee about several prominent and representative cases.

In terms of numbers of individuals involved, convictions gained, and court-ordered monetary recoveries, one of our most significant cases was a 3-year OIG investigation that revealed a complex conspiracy to defraud the FCIC and several private insurance companies. The owners of a North Carolina corporation received more than $9.28 million in crop insurance payments and attempted to obtain an additional $3.8 million via schemes involving hiding and shifting tomato production (to inflate losses) and submitting false reports and documents to insurance companies. The corporation overstated its total insured acreage in order to collect larger insurance payments. Its owners staged a "hailstorm"—complete with cocktail ice, bruised tomatoes, and a chemical spray in lieu of actual frost—and photographed the scene in order to document non-existent crop damages. Eight individuals ultimately pled guilty to charges such as conspiracy, money laundering, crop insurance fraud, perjury, and false statements.

Sentences ranged from 8 to 76 months of imprisonment and forfeiture/restitution totaled $7.3 million and $9.15 million, respectively.

A second significant case involved a North Dakota farmer and insurance broker who was ultimately ordered to forfeit $5.9 million to the Government after he and his farm business entities were found guilty at trial of 19 criminal charges. The scheme involved the creation of seven sham farming entities made up of family members and insurance agents employed by the insurance broker. Crop insurance policies were written-up for each of these fraudulent operations. Insurance losses were fabricated by shifting production from one sham farm entity to another, thereby creating false loss units. Parties with no insurable interests thereby received Federal indemnity payments. In June 2003, the insurance agent was sentenced to serve 60 months in prison and both of the farming entities were placed on probation for 5 years.

A final example of the types of schemes OIG has encountered pertained to a Texas crop insurance agency owner who was also a producer. He conspired with a crop loss adjuster in a scheme involving false statements about his wheat, cotton, and grain sorghum insurance policies and indemnity claims. Our investigation revealed that these individuals fraudulently obtained crop insurance benefits by having the crop loss adjuster prepare appraisal worksheets and production worksheets without conducting field inspections and appraisals. The producer also provided false and fictitious receipts on seed purchases. The producer was ultimately sentenced to 41 months in prison, 36 months of supervised release and was ordered to pay $448,000 to RMA. He was also prohibited from engaging in the sale of crop insurance and was excluded from USDA programs. The crop loss adjuster was sentenced to 2 years' probation and a similar restitution.

*OIG Audit Findings: The Need for Improved Federal and Private Sector Oversight*

OIG has identified the need for strong, integrated management controls and effective interagency communication, coordination, and program integration as major management

control weaknesses in our 2004, 2005, and 2006 Management Challenges reports to the Secretary.[12] Our prior audits and investigations have led us to conclude that RMA must adequately address these challenges if it is to mitigate the risks for fraud, waste, and abuse in crop insurance programs. While we recognize the positive efforts taken by RMA (such as during the SRA negotiation), we believe that effective interagency communication and program integration is essential for ARPA's successful implementation, in addition to enhancing the program integrity of the various farm programs that build upon the data, payments, and compliance activities of several USDA agencies.

In our 1999 report, we made a number of suggestions to strengthen the program's structural framework and improve its management controls; several remain directly relevant for current discussions about the program. Our primary suggestions included the need for RMA to take a more proactive role in monitoring and providing oversight of the AIPs and, most importantly, to strengthen the quality control (QC) review system.

We reiterated many of these same recommendations in our March 2002 report on RMA's QC review system.[13] We found that, despite an 8-year effort in response to earlier OIG and Government Accountability Office reports, RMA had not developed a reliable QC review system capable of evaluating the private sector's (AIP) delivery of the program. Basic policy questions remain, such as what constitutes an error, the amount of improper payments made, and at what level program delivery needed to be assessed (e.g., the AIP or crop insurance program as a whole). Since program delivery relies on private AIPs, they must be the first line of detection and prevention of program abuse and waste and improper payments. It is essential for RMA to strengthen its oversight of the AIPs' QC review systems and to validate that systemic causes for errors are identified and corrected. To date, RMA and OIG have still not reached agreement on the actions necessary to correct the concerns we have raised.

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[12] The "*Reports Consolidation Act of 2000*," P.L. 106-531, requires OIG to annually identify and report on the most serious management challenges facing USDA and its agencies.
[13] Monitoring of RMA's Implementation of Manual 14 Reviews/Quality Control Review System, Audit No. 05099-14-KC.

Our audits and investigations have consistently identified problems in the underwriting and loss adjustment review processes and with conflicts of interest, resulting in fraudulent and/or improper payments. We believe that an effective and independent QC review system, in tandem with effective monitoring and oversight by RMA, could have prevented or detected many improper payments. I would like to briefly discuss several OIG audits that illustrate situations wherein effective QC systems and improved RMA oversight could better serve the Government's interest in preventing excessive or improper crop insurance payments.

*The Watermelon Insurance Pilot Program*

In response to allegations of abuse in this program in Texas, we initiated three reviews. One focused on RMA's overall approval and review process and two focused on the eligibility of producers and the validity of their indemnity payments. OIG found that RMA, despite evidence that fall watermelons were not a suitable crop for South Texas and were not likely to produce a crop, approved this crop's inclusion in a pilot insurance program. RMA did not provide adequate oversight of the pilot program's development and approval process, particularly with respect to the actuarial risk associated with the crop. Our findings questioned $21 million in indemnity payments to fall watermelon producers in the region. Prior to our audit, RMA promptly moved to suspend the pilot program when it became aware of its impact on the market prices and allegations of abuses.

The two audits[14] that focused on producer eligibility and the validity of their indemnity payments found that, because the risk associated with planting a fall crop had not been adequately determined, the pilot program created a "moral hazard," whereby producers appeared to willfully neglect prudent management practices by planting an extremely large amount of acreage with a crop that had no more than a 10-percent chance of making it to harvest. Misrepresentation by the producer, inadequate loss adjustments, and a

[14] Watermelon Claims in South Texas, Audit No. 05601-7-Te, August 2001; and Review of Large Insurance Claim for Watermelons in South Texas, Audit No. 05601-9-Te, September 2002.

conflict of interest between the insurance agent (he leased acreage to the producer) and the producer caused over $5.5 million in improper indemnities paid.

In response to OIG's audits, RMA agreed to strengthen conflict of interest provisions to require disclosure of any business relationship between the insured parties and agents. RMA is in the process of implementing some of these provisions.[15]

*The Adjusted Gross Revenue Program*

OIG's 2007 review of a second pilot program, the Adjusted Gross Revenue Program (AGR),[16] substantiated our concerns about the AIPs' review systems (including QCs). During insurance years 2002-2003, 9 insurance providers in 18 States paid AGR indemnities totaling over $24 million. We reviewed 11 claims paid by 5 providers totaling $6.9 million, and we questioned $2.3 million of the $6.9 million in indemnity payments issued. Four of the five insurance providers we reviewed had either issued policies to producers whose eligibility was unsupported or paid indemnities for unsupported loss claims. AIP reviews at multiple levels–the application, underwriting, loss adjustment, and QC reviews–did not ensure that policies and loss claims met RMA regulations. Furthermore, RMA was not aware of the problems and, therefore, could not correct the AIPs' noncompliance. RMA has since agreed to implement procedures requiring onsite file reviews during the implementation of selected pilot programs.

*Current OIG Audit Efforts*

We currently have a total of seven audits pertaining to crop insurance issues that are ongoing, and I would like to briefly describe for the Committee two of the more noteworthy audits. We have initiated an audit of RMA's compliance activities. We are focusing on (1) organizational structure (is the control environment adequate to support

[15] Although the 2005 SRA strengthened the conflict of interest provisions, RMA issued notices in 2005 and 2006 to clarify the provisions. However, RMA's conflict of interest disclosure form for AIPs and other parties is still in the clearance process.

[16] The Adjusted Gross Revenue (AGR) Program is a non-traditional crop insurance pilot program where producers insure their farm revenue against losses caused by both natural disasters and market fluctuations. Adjusted Gross Revenue Program, Audit No. 50601-4-SF.

and sustain effective controls), (2) risk assessments (are internal and external risks and program vulnerabilities identified), and (3) policies and procedures (are controls over compliance activities in place and are they effective to identify and correct systemic weaknesses). We plan to report on this audit by the end of the year.

Another major effort we have underway is looking at RMA's management controls to ensure the timeliness and accuracy of indemnity payments for nursery crops resulting from Hurricanes Katrina and Wilma in Florida. As of January 2007, Federal crop insurance indemnity payments for losses of nursery crops in Florida due to hurricanes Katrina and Wilma totaled approximately $264 million. We are evaluating the effectiveness of the AIPs' QC review system to detect improper payments and the effectiveness of RMA's oversight and monitoring of the AIPs on the indemnities paid.

## V. Strengthening the Program Framework and Management Controls for the Crop Insurance Program: Administrative and Legislative Recommendations

*Recommendations for USDA*

If fully implemented, existing laws affecting the Federal crop insurance program (ARPA, 2002 Farm Bill, IPIA) would help strengthen the integrity of the crop insurance program. However, we also believe that more emphasis on program design, management controls, compliance, and interagency communication would reduce improper crop insurance payments. As we have recommended in our annual *Management Challenges* reports to the Secretary, we believe the following actions are critical to provide effective management of the crop insurance program and other farm programs and to prevent fraud, waste and abuse.

- **Accelerate development and implementation of CIMS.** Uniform program data and integrated data systems need to be developed and shared by RMA and FSA. Such a system may negate the time consuming reconciliation of producer

information between the two agencies. We believe that this project can serve as a model for further information sharing and coordination to ensure compliance and integrity in other farm-related agencies (e.g., Natural Resources Conservation Service) in USDA. Currently, full CIMS implementation is not anticipated until 2012.

- **Accelerate development and implementation of an effective QC review system.** A QC review system needs to incorporate elements that would provide an assessment of the delivery of the crop insurance program, whether at the AIP level or the program as a whole. While RMA requires AIPs to report discrepancies in policy data that may affect premiums, liabilities, and indemnities, individual AIPs apply inconsistent criteria for identifying and reporting errors. These inconsistent criteria provide unreliable and inconsistent results with respect to error rates and evaluating program delivery. We also believe the QC system should include incentives for good performance and disincentives for excessive error rates.

- **Finalize Implementation of ARPA.** In addition to annual reconciliation of RMA and FSA data, ARPA required RMA to identify and review claim anomalies that can be identified to any sales agent or loss adjuster.[17] Also, ARPA allowed RMA to impose civil fines and to disqualify producers, agents, loss adjusters, and AIPs for up to 5 years for willfully and intentionally providing false or inaccurate information or failing to comply with a crop insurance requirement. RMA has taken some actions to implement these provisions, but they have not been finalized.

[17] ARPA required RMA to identify and review: (1) any agent where the loss claims associated with such sales by the agent are equal or greater than 150 percent of the mean for all loss claims associated with such sales by all other agents operating in the same area, and (2) any person performing loss adjustment services relative to coverage where such loss claims resulted in accepted or denied claims equal to or greater than 150 percent of the mean for accepted or denied claims for all other persons performing loss adjustments in the same area.

- **Finalize Conflict of Interest Policies and Procedures.** RMA issued stronger conflict of interest provisions in the 2005 SRA, but the disclosure process has not been finalized. OIG provided feedback to RMA as it moved forward to issue guidance clarifying these SRA provisions. Recently, OIG provided comments to RMA on the draft of the conflict of interest disclosure form that is to be completed by AIP employees, agents, and loss adjusters.

- **Expand Data Mining.** RMA could improve program integrity and deter fraud, waste, and abuse by expanding data mining of program data for anomalous behavior or patterns by the producers, agents, and loss adjusters. The Department should also expand its data mining capabilities to other farm programs.

*Recommendations for Congress: USDA's 2007 Farm Bill Proposal*

USDA's 2007 Farm Bill proposals acknowledge that crop insurance fraud and abuse continues to be a serious concern and that an expansion of program compliance and data mining activities is needed to identify and sanction "bad actors" who are abusing the program. We agree.

USDA's Farm Bill proposal summary states that "[C]ertain statutory requirements of the crop insurance program have put its future integrity and actuarial soundness into question." The changes proposed by the Secretary can, if passed, help meet the challenge of materially improving the compliance, integrity, and actuarial soundness of the program, yet continue to provide the safety net to the American producers. We support the Department's proposals to improve the program with statutory adjustments, including the allowed loss ratio, renegotiating the SRA, AIP risk sharing, premium subsidies, and compliance activities.

OIG, through our audit and investigative efforts, will continue to support the Department's goal of improving the effectiveness and integrity of the Federal crop

insurance program, as well as protecting the safety net for American producers.

This concludes my testimony. I again want to thank the Committee for the opportunity to discuss OIG's work and perspectives regarding the Federal crop insurance program. I will be pleased to address any questions you may have.

Chairman WAXMAN. Thank you very much, Ms. Fong.

Ms. Shames.

**STATEMENT OF LISA SHAMES**

Ms. SHAMES. Chairman Waxman, Ranking Member Davis, and members of the committee, I am pleased to be here today to discuss RMA's efforts to address fraud, waste and abuse in the crop insurance program.

As you know, crop insurance protects farmers against financial losses caused by natural disasters. However, we at the GAO recently identified the Federal Crop Insurance Program to be in need of better oversight to ensure program funds are spent as economically, efficiently and effectively as possible.

Over the last 5 years, the crop insurance program cost the Government over $16 billion, of which nearly $7 billion was paid to participating insurance companies. That is, 40 cents of every dollar went to the companies, while 60 cents went to the farmer.

I plan to discuss two key points today. First, while RMA has strengthened its procedures in response to recommendations GAO made in 2005, regulatory and statutory requirements in the program's design still hinder efforts to reduce fraud, waste and abuse.

Second, compensation to the insurance companies has been excessive in light of the underwriting gains and cost allowances insurance companies receive.

First, RMA has strengthened its procedure to prevent and detect fraud, waste and abuse in the crop insurance program. RMA provides information more frequently on suspect claims so that field inspections can be more timely and has drafted regulations that, when final, will allow it to use its expanded sanction authority on program violators.

Positively, RMA reports cost savings of over $300 million in the form of avoided payments from 2001 to 2004. Nonetheless, we found the program's design as laid out in RMA's regulations or as required by statute, can impeded RMA's efforts in a number of ways.

In terms of RMA's regulations, farmers have the option of insuring their crop in multiple units or combined as one unit. Insuring their crops in multiple units can make it easier to file false insurance claims because a farmer can shift production to one field and file a false claim for loss on the other field. We found that 12 percent of farmers identified as having irregular claims were suspected of this switching among their fields.

RMA disagreed with our recommendation to reduce the insurance guarantee or to eliminate this coverage to farmers whose claims compare irregularly to others in the area.

In terms of statutory requirements, RMA is obligated by law to offer farmers coverage if an insured crop is prevented from being planted because of weather conditions. It is often difficult to determine whether farmers had the opportunity to plant the crop. Also, this preventive planting coverage is expensive. RMA pays about $300 million annually in claims.

My second point this morning is that compensation to the insurance companies has been excessive. USDA pays both underwriting gains and cost allowances as negotiated in the contract with the

companies, the standard reinsurance agreement, or SRA. Underwriting gains totaled $2.8 billion from 2002 through 2006. These gains represent an average annual rate of return of 17.8 percent. This rate of return is considerably higher than the benchmark for private property and casualty insurance, which is 6.4 percent.

USDA had a one time authority to renegotiate the financial terms of its SRA with the companies in 2005. Nonetheless, in 2005, the insurance companies received a rate of return of 30 percent, and in 2006 the rate of return was 24 percent. Companies received these gains despite drought conditions in parts of the country that would normally suggest they would earn lower profits.

In addition to underwriting gains, USDA paid a cost allowance to the insurance companies of $4 billion to cover administrative and operating expenses for program delivery from 2002 to 2006. USDA expects these expenses to increase by about 25 percent by 2008 because of higher crop prices, particularly for corn and soybeans. Higher crop prices increase the value of the policy. This means that companies will receive a higher cost allowance without a corresponding increase in expenses for selling or servicing the policies.

Congress has an opportunity in reauthorizing the farm bill to provide USDA with the authority to periodically renegotiate the financial terms of the SRA so that the companies' rate of return is more in line with private insurance markets.

In conclusion, Federal crop insurance plays an invaluable role in protecting farmers. Nonetheless, we identified crop insurance as a program in need of enhanced congressional oversight because we cannot afford to continue businesses as usual, given the Nation's current deficit and growing long-term fiscal challenges. RMA has made progress in addressing fraud, waste and abuse, but weaknesses we identified in the program design continue to leave the crop insurance program vulnerable.

Furthermore, RMA's efforts to limit program costs has had minimal effect. Congress has an opportunity in its reauthorization of the farm bill to bring costs more in line with the private insurance industry. Such a step can help position the Nation to meet its fiscal responsibilities by saving hundreds of millions of dollars annually.

Mr. Chairman, this concludes my prepared statement. I would be pleased to answer any questions that you or members of the committee may have.

[The prepared statement of Ms. Shames follows:]

United States Government Accountability Office

GAO

Testimony

Before the Committee on Oversight and Government Reform, House of Representatives

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# CROP INSURANCE

# Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable

Statement of Lisa Shames, Acting Director
Natural Resources and Environment

GAO-07-819T

May 3, 2007

GAO
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**Highlights**

Highlights of GAO-07-819T, a testimony before the Committee on Oversight and Government Reform, House of Representatives

# CROP INSURANCE

## Continuing Efforts Are Needed to Improve Program Integrity and Ensure Program Costs Are Reasonable

### Why GAO Did This Study

The U.S. Dept. of Agriculture's (USDA) Risk Management Agency (RMA) administers the federal crop insurance program in partnership with private insurers. In 2006, the program cost $3.5 billion, including millions in losses from fraud, waste, and abuse, according to USDA. The Agricultural Risk Protection Act of 2000 granted RMA authority to renegotiate the terms of RMA's standard reinsurance agreement with companies once over 5 years.

This testimony is based on GAO's 2005 report, *Crop Insurance: Actions Needed to Reduce Program's Vulnerability to Fraud, Waste, and Abuse*, as well as new analyses this Committee requested on underwriting gains and administrative and operating expenses USDA paid companies. GAO discusses (1) USDA's processes to address fraud, waste, and abuse; (2) extent the program's design makes it vulnerable to abuse; and (3) reasonableness of underwriting gains and other expenses. USDA agreed with most of GAO's 2005 recommendations to improve program integrity. RMA agreed that GAO's new analyses were technically accurate.

### What GAO Recommends

Congress has an opportunity in the Farm Bill reauthorization to grant RMA authority to periodically renegotiate the financial terms of its agreement with companies to provide reasonable cost allowances and underwriting gains.

www.gao.gov/cgi-bin/getrpt?GAO-07-819T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Lisa Shames at (202) 512-3841 or shamesl@gao.gov.

### What GAO Found

GAO reported that RMA did not use all available tools to reduce the crop insurance program's vulnerability to fraud, waste, and abuse. RMA has since taken some steps to improve its procedures. In particular:

- *USDA's Farm Service Agency (FSA) inspections during the growing season were not being used to maximum effect.* Between 2001 and 2004, FSA conducted only 64 percent of the inspections RMA requested. Without inspections, farmers may falsely claim crop losses. However, FSA said it could not conduct all requested inspections, as GAO recommended, because of insufficient resources. RMA now provides information more frequently so FSA can conduct timelier inspections.
- *RMA's data analysis of the largest farming operations was incomplete.* In 2003, about 21,000 of the largest farming operations did not report all of the individuals or entities with an ownership interest in these operations, as required. Therefore, RMA was unaware of ownership interests that could help it prevent potential program abuse. FSA and RMA now share information to identify such individuals or entities. USDA should be able to recover up to $74 million in improper payments made during 2003.
- *RMA was not effectively overseeing insurance companies' efforts to control program abuse.* According to GAO's review of 120 cases, companies did not complete all the required quality assurance reviews of claims, and those that were conducted were largely paper exercises. RMA agreed to improve oversight of their reviews, but GAO has not followed up to examine its implementation.

RMA's regulations to implement the crop insurance program, as well as some statutory requirements, create design problems that hinder its efforts to reduce abuse. For example, the regulations allow farmers to insure fields individually rather than together. As such, farmers can "switch" reporting of yield among fields to make false claims or build up a higher yield history on a field to increase its eligibility for higher insurance guarantees. RMA did not agree with GAO's recommendation to address the problems associated with insuring individual fields. Statutorily high premium subsidies may also limit RMA's ability to control program abuse: the subsidies shield farmers from the full effect of paying higher premiums associated with frequent claims.

From 2002 through 2006, USDA paid the insurance companies underwriting gains of $2.8 billion, which represents an average annual rate of return of 17.8 percent. In contrast, according to insurance industry statistics, the benchmark rate of return for companies selling property and casualty insurance was 6.4 percent. USDA renegotiated the financial terms of its standard reinsurance agreement with the companies in 2005, but their rate of return was 30.1 percent in 2005, and 24.3 percent in 2006. It also paid the companies a cost allowance of $4 billion to cover administrative and operating costs for 2002 through 2006. USDA recommended that Congress provide RMA with authority to renegotiate the financial terms and conditions of its standard reinsurance agreement once every 3 years.

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the U.S. Department of Agriculture's (USDA) efforts to address fraud, waste, and abuse in the federal crop insurance program. As you know, federal crop insurance is part of the overall safety net of programs for American farmers. It provides protection against financial losses caused by droughts, floods, or other natural disasters. USDA's Risk Management Agency (RMA) supervises the Federal Crop Insurance Corporation's (FCIC) operations and has overall responsibility for administering the crop insurance program, including controlling costs and protecting against fraud, waste, and abuse. RMA also partners with private insurance companies that sell and service the insurance policies and share a percentage of the risk of loss and opportunity for gain associated with each policy.

In November 2006, we identified the federal crop insurance program as a program in need of better oversight to ensure program funds are spent as economically, efficiently, and effectively as possible.[1] In 2006, the crop insurance program provided $50 billion in insurance coverage for 242 million acres of farmland, at a cost of $3.5 billion to the federal government, of which a total of $1.8 billion was paid to insurance companies for their participation in the crop insurance program.[2] USDA reports that an estimated $62 million in indemnity payments were made in 2006 as a result of waste, such as incorrect payments or payments based on incomplete or missing paperwork.[3]

To improve the integrity of the crop insurance program, among other things, Congress enacted the Agricultural Risk Protection Act of 2000 (known as ARPA). ARPA provided RMA and USDA's Farm Service Agency (FSA) with new tools for monitoring and controlling program abuses.[4] ARPA required the Secretary of Agriculture to develop and implement a

[1]GAO, *Suggested Areas for Oversight for the 110th Congress*, GAO-07-235R (Washington, D.C.: Nov. 17, 2006).

[2]Cost data in this testimony are reported on a fiscal year basis. Program data are reported on a crop year basis.

[3]See U.S. Department of Agriculture, *FY 2006 Performance and Accountability Report* (Washington, D.C.: Nov. 15, 2006). RMA officials indicated that they have not developed an estimate of losses attributable to fraud and abuse.

[4]FSA is generally responsible for helping producers enroll in agriculture support programs, overseeing these programs, and issuing program payments.

coordinated plan for FSA to assist RMA in the ongoing monitoring of the crop insurance program and to use information technologies, such as data mining—the analysis of data to establish relationships and identify patterns—to administer and enforce the program. Furthermore, ARPA provided USDA with the authority to renegotiate the financial terms of its contractual agreement—known as the standard reinsurance agreement (SRA)—with the private insurance companies once during 2001 through 2005. USDA renegotiated the terms of the SRA in 2004 and implemented the new agreement in 2005. In its recent Farm Bill proposal, USDA recommended that Congress provide the agency with authority to renegotiate the financial terms and conditions once every 3 years. RMA officials also told us they sought legislative remedies to address excessive underwriting gains in their budget proposals for fiscal years 2006 and 2007. The SRA between USDA and the insurance companies includes (1) a cost allowance that is tied to the value of the policy and that is intended to cover administrative and operating expenses incurred by the companies for program delivery, and (2) risk-sharing formulas that establish underwriting gains and losses.

GAO has issued reports on the federal crop insurance program that have raised a number of concerns. (See Related GAO Products.) Most recently, in June 2006, we reported that some farmers may have abused the crop insurance program by allowing crops to fail through neglect or deliberate actions in order to collect insurance, and some insurance companies have not exercised due diligence in investigating losses and paying claims.[5] In addition, the effects of climate change, including rising temperatures and increasingly frequent and intense droughts, storms, and flooding, may be potentially significant in coming decades and affect the program's financial costs to the government. As we recently reported,[6] major private and federal insurers are both exposed to the effects of climate change over the coming decades, but are responding differently. Many large private insurers are incorporating climate change into their annual risk management practices, and some are addressing it strategically by assessing its potential long-term, industrywide impacts. However, the

[5]GAO, *Crop Insurance: More Needs to Be Done to Reduce Program's Vulnerability to Fraud, Waste, and Abuse,* GAO-06-878T (Washington, D.C.: June 15, 2006), and *Crop Insurance: Actions Needed to Reduce Program's Vulnerability to Fraud, Waste, and Abuse,* GAO-05-528 (Washington, D.C.: September 30, 2005).

[6]GAO, *Climate Change: Financial Risks to Federal and Private Insurers in Coming Decades Are Potentially Significant,* GAO-07-285 (Washington, D.C.: March 16, 2007).

major federal insurance programs, including the crop insurance program, have done little to develop comparable information.

My testimony today focuses on the (1) effectiveness of USDA's procedures to prevent and detect fraud, waste, and abuse in selling and servicing crop insurance policies; (2) extent to which program design issues may make the program more vulnerable to fraud, waste, and abuse; and (3) reasonableness of underwriting gains and administrative and operating expenses USDA pays to the companies for program delivery. My testimony is primarily based on published GAO products. In addition, at the request of this Committee, we analyzed underwriting gains and losses and administrative and operating expenses. RMA reviewed these analyses and told us they were technically accurate. We performed our work in accordance with generally accepted government auditing standards.

In summary, since the enactment of ARPA, RMA has taken a number of steps to improve its procedures to prevent and detect fraud, waste, and abuse in the crop insurance program. Most notably, RMA reports that data mining analyses and subsequent communication to farmers resulted in a decline of at least $300 million in questionable claims payments from 2001 to 2004. However, we found that, at the time our review, RMA was not effectively using all of the tools it had available and that some farmers and others continued to abuse the program. We identified weaknesses in four key areas: (1) field inspections, (2) data mining processes that exclude many large farming operations when farmers do not report their interest in them, (3) quality assurance reviews conducted by insurance companies, and (4) imposition of sanctions. Weaknesses in these areas left the program vulnerable to questionable claims, and the insurance companies and RMA could not always determine the validity of a claim to minimize fraud, waste, and abuse. RMA has taken steps on some of the recommendations we made. For example, RMA amended its crop insurance policy manual to provide information more frequently to FSA on suspect claims so that FSA is able to conduct timelier field inspections to detect potential abuse. In another case, we recommended that RMA promulgate regulations needed to fully utilize its expanded sanction authority provided under ARPA. In response, RMA developed draft regulations that, when final, will allow the agency to fully use this authority to sanction program violators.

We also found that the program's design, as laid out in RMA's regulations or as required by statute, can impede the efforts of RMA officials to prevent and detect fraud, waste, and abuse in a number of ways. In terms of RMA's regulations, farmers can insure their fields individually instead of

insuring all fields combined, which makes it easier for them to switch production among fields, either to make false insurance claims or to build up a higher yield history on a particular field in order to increase its eligibility for higher future insurance guarantees. RMA disagreed with our recommendation to reduce the insurance guarantee or eliminate optional unit coverage for producers who consistently have claims that are irregular in comparison with other producers growing the same crop in the same location. RMA stated that our recommendation represents a disproportionate response, considering the small number of producers who switch the yield on a field each year. Nevertheless, we continue to believe that RMA could tailor an underwriting rule to target those relatively few farmers who file anomalous claims related to yield switching. In terms of statutory requirements, RMA is obligated by law to offer farmers "prevented planting" coverage—coverage that allows for insurance claims if an insured crop is prevented from being planted because of weather conditions, but it is often difficult to determine whether farmers had the opportunity to plant a crop. In our 2006 testimony, we stated that Congress may wish to consider allowing RMA to reduce premium subsidies—and hence raise the insurance premiums—for farmers who consistently have claims, such as prevented planting claims, that are irregular in comparison with other farmers growing the same crop in the same location. To date, Congress has not granted RMA the authority to make such reductions.

Finally, USDA paid the insurance companies underwriting gains of $2.8 billion, in total, from 2002 through 2006. The underwriting gains represent an average annual rate of return of 17.8 percent over this 5-year period.[7] This rate of return is considerably higher than the insurance industry average. According to insurance industry statistics, the benchmark rate of return for U.S. insurance companies selling private property and casualty insurance was 6.4 percent during this period. RMA officials told us that this benchmark rate can be considered a starting point for measuring the appropriateness of the underwriting gains in the crop insurance program. As previously noted, USDA renegotiated the financial terms of its SRA with the companies beginning with the 2005 planting season. Nonetheless, in 2005, USDA still paid insurance companies underwriting gains of $916 million—a rate of return of 30.1 percent. In 2006, USDA paid underwriting gains of $886 million—a rate of return of 24.3 percent. The companies

[7]In this testimony, we define rate of return as underwriting gains calculated as a percentage of premiums on the policies in which companies retain risk of loss.

received these underwriting gains despite drought conditions in parts of the country in 2005 and 2006 that would normally suggest they would earn lower profits. In addition to underwriting gains, USDA paid the insurance companies $4 billion in cost allowances to cover administrative and operating expenses incurred for program delivery from 2002 through 2006. USDA expects the cost allowance paid per policy to increase by about 25 percent by 2008 because of higher crop prices, particularly for corn and soybeans. These higher crop prices increase the value of the policy. However, the companies and their affiliated sales agents will receive this substantially higher cost allowance without any corresponding increase in expenses for selling and servicing the policies. Congress has an opportunity in its reauthorization of the Farm Bill to provide USDA with the authority to periodically renegotiate the financial terms of the standard reinsurance agreement with the insurance companies so that the companies' rate of return is more in line with private insurance markets. USDA has requested the authority to renegotiate the SRA in its proposals for the Farm Bill.

## Background

FCIC was established in 1938 to temper the economic impact of the Great Depression, and was significantly expanded in 1980 to protect farmers from the financial losses brought about by drought, flood, or other natural disasters. RMA administers the program in partnership with private insurance companies, which share a percentage of the risk of loss and the opportunity for gain associated with each insurance policy written. RMA acts as a reinsurer—reinsurance is sometimes referred to as insurance for the insurance companies—for a portion of all policies the federal crop insurance program covers. In addition, RMA pays companies a percentage of the premium on policies sold to cover the administrative costs of selling and servicing these policies. In turn, insurance companies use this money to pay commissions to their agents, who sell the policies, and fees to adjusters when claims are filed.

FCIC insures agricultural commodities on a crop-by-crop and county-by-county basis, considering farmer demand and the level of risk associated with the crop in a given region. Major crops, such as grains, are covered in almost every county where they are grown, while specialty crops such as fruit are covered in only some areas. Participating farmers can purchase different types of crop insurance and at different levels.

RMA establishes the terms and conditions that the private insurance companies selling and servicing crop insurance policies are to use through the SRA. The SRA provides for the cost allowance intended to cover

administrative and operating expenses the companies incur for the policies they write, among other things. The SRA also establishes the minimum training, quality control review procedures, and performance standards required of all insurance providers in delivering any policy insured or reinsured under the Federal Crop Insurance Act, as amended.

Under the crop insurance program, participating farmers are assigned (1) a "normal" crop yield based on their actual production history and (2) a price for their commodity based on estimated market conditions. Farmers can then select a percentage of their normal yield to be insured and a percentage of the price they wish to receive if crop losses exceed the selected loss threshold. In addition, under the crop insurance program's "prevented planting" provision, insurance companies pay farmers who were unable to plant the insured crop because of an insured cause of loss that was general to their surrounding area, such as weather conditions causing wet fields, and that had prevented other farmers in that area from planting fields with similar characteristics. These farmers are entitled to claims payments that generally range from 50 to 70 percent, and can reach as high as 85 percent, of the coverage they purchased, depending on the crop.

RMA is responsible for protecting against fraud, waste, and abuse in the federal crop insurance program. In this regard, RMA uses a broad range of tools, including RMA's compliance reviews of companies' procedures, companies' quality assurance reviews of claims, data mining, and FSA's inspections of farmers' fields. For example, insurance companies must conduct quality assurance reviews of claims that RMA has identified as anomalous or of those claims that are $100,000 or more to determine whether the claims the companies paid comply with policy provisions.

Congress enacted ARPA, amending the Federal Crop Insurance Act, in part, to improve compliance with, and the integrity of, the crop insurance program. Among other things, ARPA provided RMA authority to impose sanctions against producers, agents, loss adjusters, and insurance companies that willfully and intentionally provide false or inaccurate information to FCIC or to an insurance company—previously, RMA had authority to impose sanctions only on individuals who willfully and intentionally provided false information. It also provided RMA with authority to impose sanctions against producers, agents, loss adjusters, and insurance companies for willfully and intentionally failing to comply with any other FCIC requirement. In addition, it increased the percentage share of the premium the government pays for most coverage levels of crop insurance, beginning with the 2001 crop year. The percentage of the

premium the government pays declines as farmers select higher levels of coverage. However, ARPA raised the percentage of federal subsidy for all levels of coverage, particularly for the highest levels of coverage. For example, the government now pays more than one-half of the premium for farmers who choose to insure their crop at 75-percent coverage.

## RMA Has Strengthened Procedures for Preventing Questionable Claims, but the Program Remains Vulnerable to Potential Abuse

RMA has taken a number of steps to improve its procedures to prevent and detect fraud, waste, and abuse, such as data mining, expanded field inspections and quality assurance reviews. In particular, RMA now develops a list of farmers each year whose operations warrant an on-site inspection during the growing season because data mining uncovered patterns in their past claims that are consistent with the potential for fraud and abuse. The list includes, for example:

- farmers, agents, and adjusters linked in irregular behavior that suggests collusion;
- farmers who for several consecutive years received most of their crop insurance payments from prevented planting indemnity payments;
- farmers who appear to have claimed the production amounts for multiple fields as only one field's yield, thereby creating an artificial loss on their other field(s); and
- farmers who, in comparison with their peers, file unusually high claims for lost crops over many years.

Since RMA began performing this data mining in 2001, it has identified about 3,000 farmers annually who warrant an on-site inspection because of anomalous claims patterns. In addition, RMA annually performs about 100 special analyses to identify areas of potential vulnerability and trends in the program.

RMA also provides the names of farmers from its list of suspect claims for inspection to the appropriate FSA state office for distribution to FSA county offices, as well as to the insurance companies selling the policies to farmers. As a result of these inspections and other information, RMA reported total cost savings of $312 million from 2001 to 2004, primarily in the form of estimated payments avoided. For example, according to RMA, claims payments to farmers identified for an inspection decreased nationwide from $234 million in 2001 to $122 million in 2002. According to RMA, some of the farmers on the list for filing suspect claims bought less

insurance and a few dropped crop insurance entirely, but most simply changed their behavior regarding loss claims.

However, as we testified in 2006, RMA was not effectively using all of the tools it had available and that some farmers and others continued to abuse the program, as the following discussion indicates.

*Inspections during the growing season were not being used to maximum effect.* FSA was not providing RMA with inspection assistance in accordance with USDA guidance. For example, between 2001 and 2004, farmers filed claims on about 380,000 policies annually, and RMA's data mining identified about 1 percent of these claims as questionable and needing FSA's inspection. Under USDA guidance, FSA should have conducted all of the 11,966 requested inspections, but instead conducted only 64 percent of them; FSA inspectors said that they did not conduct all requested inspections primarily because they did not have sufficient resources. Moreover, between 2001 and 2004, FSA offices in nine states did not conduct any of the field inspections RMA had requested in one or more of the years. Until we brought this matter to their attention in September 2004, FSA headquarters officials were unaware that the requested inspections in these nine states had not been conducted. Furthermore, FSA might not have been as effective as possible in conducting field inspections because RMA did not provide it with information on the nature of the suspected abusive behavior or the results of follow-up investigations. Finally, these inspections did not always occur in a timely fashion during the growing season. Because of these problems, the insurance companies and RMA could not always determine the validity of a claim.

USDA has implemented some of our recommendations to improve inspection practices. For example, we recommended that RMA more consistently inform FSA of the suspect claim patterns that it should investigate. RMA amended its crop insurance policy manual to provide information more frequently to FSA on suspect claims, as we recommended, so that FSA can conduct timelier field inspections to detect potential abuse. Specifically, RMA now provides a list twice a year—in the fall for crops such as wheat, and in the spring for crops such as corn and soybeans. However, FSA disagreed with our recommendation that it conduct all inspections called for under agency guidance, citing insufficient resources as the reason. Nevertheless, we believe that conducting these inspections would achieve potentially substantial savings for the crop insurance program by identifying cases of fraudulent claims.

*RMA's data analysis of the largest farming operations was incomplete.* RMA's data mining analysis excluded comparisons of the largest farming operations—including those organized as partnerships and joint ventures. These entities may include individuals who are also members of one or more other entities. Because it did not know the ownership interests in the largest farming operations, RMA could not readily identify potential fraud. For example, farmers who are members of more than one farming operation could move production from one operation to another to file unwarranted claims, without RMA's knowledge that these farmers participate in more than one farming operation. RMA could not make these comparisons because it had not been given access to similar data that FSA maintains. However, ARPA required the Secretary of Agriculture to develop and implement a coordinated plan for RMA and FSA to reconcile all relevant information received by either agency from a farmer who obtains crop insurance coverage.

Using FSA data, we examined the extent to which (1) farming operations report all members who have a substantial beneficial interest in the operation, (2) these farming operations file questionable crop insurance claims, and (3) agents or claims adjusters had financial interests in the claim.[8] By comparing RMA's and FSA's databases, we found that 21,310 farming entities, or about 31 percent of all farming entities, did not report one or more members who held a beneficial interest of 10 percent or more in the farming operation holding the policy. RMA should be able to recover a portion of these payments because, according to RMA regulations, if the policyholder fails to disclose an ownership interest in the farming operation, the policyholder must repay the amount of the claims payment that is proportionate to the interest of the person who was not disclosed.[9] According to our analysis, RMA should be able to recover up to $74 million in claims payments for 2003. USDA has since implemented our recommendation that FSA and RMA share information on policyholders to better identify fraud, waste, and abuse. In addition, of the 21,310 entities failing to disclose ownership interest in 2003, we found 210 entities with suspicious insurance claims totaling $11.1 million. Finally, we identified 24 crop insurance agents who sold policies to farming entities in which the

[8]The Center for Agribusiness Excellence conducted this analysis at our request. The Center, located at Tarleton State University in Stephenville, Texas, provides research, training, and resources for data warehousing and data mining of agribusiness and agriculture data. The Center provides data mining of crop insurance data for RMA.

[9]7 C.F.R. § 457.8.

agents held a substantial beneficial interest but failed to report their ownership interest to RMA as required. USDA has since implemented our recommendation that FSA and RMA share information on policyholders to better identify fraud, waste, and abuse. RMA, however, has not implemented our recommendation to recover claims payments to ineligible farmers or to entities that failed to fully disclose ownership interest.

*RMA was not effectively overseeing insurance companies' quality assurance programs.* RMA guidance requires insurance companies to provide oversight to properly underwrite the federal crop insurance program, including implementing a quality control program, conducting quality control reviews, and submitting an annual report to FCIC. However, RMA was not effectively overseeing insurance companies' quality assurance programs, and for the claims we reviewed, it did not appear that most companies were rigorously carrying out their quality assurance functions. For example, 80 of the 120 insurance files we reviewed claimed more than $100,000 in crop losses or met some other significant criteria; RMA's guidance states that the insurance provider must conduct a quality assurance review for such claims. However, the insurance companies conducted reviews on only 59 of these claims, and the reviews were largely paper exercises, such as computational verifications, rather than comprehensive analysis of the claim. RMA did not ensure that companies conducted all reviews called for under its guidance and did not examine the quality of the companies' reviews. RMA agreed with our recommendation to improve oversight of companies' quality assurance programs, but we have not yet followed up with the agency to examine its implementation.

*RMA has infrequently used its new sanction authority to address program abuses.* RMA had only used its expanded sanction authority granted under ARPA on a limited basis. It had identified about 3,000 farmers with suspicious claims payments—notable policy irregularities compared with other farmers growing the same crop in the same county—each year since the enactment of ARPA. While not all of these policies with suspicious claims were necessarily sanctionable, RMA imposed only 114 sanctions from 2001 through 2004. According to RMA officials, RMA requested and imposed few sanctions because it had not issued regulations to implement its expanded authority under ARPA. Without regulations, RMA had not established what constitutes an "FCIC requirement" and not explained how it would determine that a violation had occurred or what procedural process it would follow before imposing sanctions. RMA agreed with our recommendation that it promulgate regulations to implement its expanded

authority, and has developed draft regulations. Once final, these regulations will allow the agency to fully use this authority to sanction program violators.

## RMA's Regulations and Some Statutory Requirements Hinder Efforts to Reduce Abuse in the Crop Insurance Program

While RMA can improve its day-to-day oversight of the federal crop insurance program in a number of ways, the program's design, as laid out in RMA's regulations or as required by statute, hinders the agency's efforts to administer certain program provisions in order to prevent fraud, waste, and abuse, as the following discussion indicates.

*RMA's regulations allow farmers the option of insuring their fields individually rather than combined as one unit.* Farmers can insure production of a crop on an individual field (optional units) or all their fields as one unit. Farmers may want to insure fields separately out of concern that they could experience losses in a certain field because of local weather conditions, such as hail or flooding. If farmers instead insure their entire crop in a single basic insurance unit, the hail losses might not cause the production yield of all units combined to be below the level guaranteed by the insurance and, therefore, would not warrant an indemnity payment. Although insurance on individual fields provides farmers added protection against loss, this optional unit coverage increases the potential for fraud and abuse in the crop insurance program.

Insuring fields separately enables farmers to "switch" production among fields—reporting production of a crop from one field that is actually produced on another field—either to make false insurance claims based on low production or to build up a higher yield history on a particular field in order to increase that field's eligibility for higher future insurance guarantees. We reported that of the 2,371 farmers identified as having irregular claims in 2003, 12 percent were suspected of switching production among their fields.

According to a 2002 RMA study, losses per unit (e.g., a field) increase as the number of separately insured optional units increases.[10] However, according to an RMA official, gathering the evidence to support a yield-switching fraud case requires considerable resources, especially for large farming operations. RMA disagreed with our recommendation to reduce

[10] *Final Research Report For Multiple Year Coverage*, Task Order # RMA-RED-01-06, Watts and Associates, Inc., June 27, 2002.

the insurance guarantee or eliminate optional unit coverage for farmers who consistently have claims that are irregular in comparison with other farmers growing the same crop in the same location. It stated that our recommendation represents a disproportionate response, considering the small number of producers who engage in yield switching each year, and that the adoption of our recommendation would not be cost effective. Nevertheless, we continue to believe that RMA could tailor an underwriting rule so that it would target only a few producers each year and would entail few resources. Such a tool would provide RMA another means to discourage producers from abusing the program.

*Minimal risk sharing on some policies, as set by statute, may not provide insurance companies with a strong incentive to carry out their responsibilities under the program.* In some cases, insurance companies have little incentive to rigorously challenge questionable claims. Insurance companies participating in the crop insurance program share a percentage of the risk of loss or opportunity for gain on each insurance policy they write, but the federal government ultimately bears a high share of the risk. Under the SRA, insurance companies are allowed to assign policies to one of three risk funds—assigned risk, developmental, or commercial. The SRA provides criteria for assigning policies to these funds. For the assigned risk fund, the companies cede up to 85 percent of the premium and associated liability for claims payments to the government and share a limited portion of the gains or losses on the policies they retain. For the developmental and commercial funds, the companies cede a smaller percent of the premium and associated liability for claims payments to the government.

Economic incentives to control program costs associated with fraud, waste, and abuse are commensurate with financial exposure. Therefore, for policies placed in the assigned risk fund, companies have far less financial incentive to investigate suspect claims. For example, in one claim file we reviewed, an insurance company official characterized the farmer as filing frequent, questionable claims; however, the company paid a claim of over $500,000. The official indicated that if the company had vigorously challenged the claim, the farmer would have defended his claim just as vigorously, and the company would have potentially incurred significant litigation expenses, which RMA does not specifically reimburse. With this cost and reimbursement structure, in the company's opinion, it was less costly to pay the claim.

*RMA and insurance companies have difficulty determining potential abuse associated with statutory coverage for prevented planting.* Under the

Federal Crop Insurance Act, as amended, RMA must offer prevented planting coverage. RMA allows claims for prevented planting if farmers cannot plant owing to an insured cause of loss that is general in the surrounding area and that prevents other farmers from planting acreage with similar characteristics. Claims for prevented planting are paid at a reduced level, recognizing that farmers do not incur all production costs associated with planting and harvesting a crop. However, determining whether farmers can plant their crop may be difficult. Annually, RMA pays about $300 million in claims for prevented planting.

*Statutorily high premium subsidies may inhibit RMA's ability to control program abuse.* ARPA increased premium subsidies—the share of the premium paid by the government—but this increase may hamper RMA's ability to control program fraud, waste, and abuse. Premium subsidies are calculated as a percentage of the total premium, and farmers pay only between 33 to 62 percent of the policy premium, depending on coverage level. High premium subsidies shield farmers from the full effect of paying higher premiums. Because premium rates are higher in riskier areas and for riskier crops, the subsidy structure transfers more federal dollars to those who farm in riskier areas or produce riskier crops.

In addition, by regulation, premium rates are higher for farmers who choose to insure their fields separately under optional units, rather than all fields combined, because the frequency of claims payments is higher on the separately insured units. Again, however, because of high premium subsidies, farmers pay only a fraction of the higher premium. Thus, the subsidy structure creates a disincentive for farmers to insure all fields combined. Over one-half (56 percent) of the crop insurance agents responding to the survey conducted for our 2005 report believed that charging higher premiums for farmers with a pattern of high or frequent claims would discourage fraud, waste, and abuse in the crop insurance program. In our 2006 testimony, we stated that Congress may wish to consider allowing RMA to reduce premium subsidies—and hence raise the insurance premiums—for farmers who consistently have claims that are irregular in comparison with other farmers growing the same crop in the same location. To date, no action has been taken.

## Compensation to Insurance Companies Has Been Excessive

From 1997 through 2006, USDA paid over $10.9 billion to companies that participate in the federal crop insurance program in cost allowances and underwriting gains, as table 1 shows. The $10.9 billion in total payments to the companies represents 42 percent of the government's cost of the crop insurance program—about $26 billion—over this period. That is, more

than 40 cents of every dollar the government spent on the federal crop insurance program went to the companies that deliver the program, while less than 60 cents went to farmers. While we provide 10 years of data to offer a broad perspective and to even out annual losses and gains, the most recent 5 years of data—2002 to 2006—show similar results.

**Table 1: Cost Allowances and Underwriting Gains Paid to Insurance Companies, and Government Costs, 1997 through 2006**

Dollars in millions

| | Payments to insurance companies | | | |
|---|---|---|---|---|
| Year | Company cost allowance | Company underwriting gain (loss) | Total payments to insurance companies | Government cost for the crop insurance program[a] |
| 1997 | $437.8 | $352.1 | $789.9 | $1,095.9 |
| 1998 | 443.3 | 279.2 | 722.5 | 1,373.8 |
| 1999 | 500.7 | 271.8 | 772.5 | 1,782.7 |
| 2000 | 552.1 | 267.8 | 819.9 | 2,175.1 |
| 2001 | 642.0 | 345.9 | 987.9 | 3,162.6 |
| 2002 | 625.9 | (47.5) | 578.4 | 3,465.6 |
| 2003 | 733.9 | 377.9 | 1,111.8 | 3,588.7 |
| 2004 | 890.0 | 691.9 | 1,581.9 | 3,125.7 |
| 2005 | 829.6 | 916.2 | 1,745.8 | 2,698.5 |
| 2006 | 949.8 | 885.9 | 1,835.7 | 3,462.0 |
| **Total—1997 to 2006** | **$6,605.1** | **$4,341.2** | **$10,946.3** | **$25,930.6** |
| **Total—2002 to 2006** | **$4,029.2** | **$2,824.4** | **$6,853.6** | **$16,340.5** |

Source: GAO's analysis of RMA's data.

Notes: (1) Cost data are reported on a fiscal year basis. (2) Payments to companies are reported on a crop year basis. (3) Totals may not add due to rounding.

[a]Government costs also include total indemnities and other administrative and operating expenses, including certain costs for research, development, and other activities. This total is reduced by the premiums and administration fees that farmers pay.

As discussed earlier, USDA pays both underwriting gains and cost allowances, as negotiated in the SRA. Since the crop insurance program was revised under ARPA—that is, from 2002 through 2006—USDA has paid the insurance companies a total of $2.8 billion in underwriting gains. In terms of profitability, these underwriting gains represent an average

annual rate of return of 17.8 percent over this 5-year period.[11] According to industry statistics, the benchmark rate of return for U.S. insurance companies selling private property and casualty insurance was 6.4 percent during this period.[12] RMA officials told us that this benchmark rate can be considered a starting point for measuring the appropriateness of the underwriting gains in the crop insurance program. However, they stated that this program should have a somewhat higher rate of return because of the (1) high volatility of underwriting gains for this program compared with the relatively steady gains associated with the property and casualty insurance industry, and (2) lack of investment opportunities when participating in the program because premiums are paid to the companies at harvest, not when farmers purchase a policy. But these officials also said that current rates of return are excessive. USDA renegotiated the financial terms of its SRA with the companies beginning with the 2005 planting season. In 2005, USDA paid the insurance companies underwriting gains of $916 million—a rate of return of 30.1 percent. In 2006, USDA paid them underwriting gains of $886 million—a rate of return of 24.3 percent. The companies received these underwriting gains despite drought conditions in parts of the country in 2005 and 2006. Adverse weather conditions, such as drought, normally suggest that insurance companies would earn lower profits because of greater producer losses.

In addition to underwriting gains, RMA pays companies a cost allowance to cover program delivery expenses. The allowance is calculated as a percentage of total premiums on the insurance policies that they sell. Because the cost allowance is not tied to specific expenses, the companies can use the payments in any way they choose. From 2002 through 2006, USDA paid the insurance companies over $4 billion in cost allowances. Because the cost allowance is a percentage of the premiums, it also increases when the value of policies companies sell increases, as it does when crop prices rise. For example, USDA expects the value of policies, and thereby the cost allowances paid to companies, to increase by about 25 percent from 2006 through 2008. USDA expects these higher policy

[11]Similarly, over the 10-year period, from 1997 through 2006, USDA paid companies participating in the crop insurance program underwriting gains of $4.3 billion, which represents an average annual rate of return of 17.8 percent.

[12]*Best's Aggregates and Averages: Property/Casualty, United States and Canada.* (Oldwick, New Jersey: 2006). According to this publication, the benchmark rate of return for property and casualty insurance for the 10-year period ending in 2005 (the most recent year data were available) was 6.9 percent. For calculating the rate of return, we used Best's ratio of pre-tax operating income to net premium earned.

values, and ultimately higher cost allowances, because of external factors, including higher crop prices, particularly for corn and soybeans. Consequently, the companies and their affiliated sales agents will receive substantially higher cost allowances without any corresponding increase in expenses for selling and servicing the policies. Substantially higher cost allowances provide these companies and their agents with a kind of windfall. Greater insurance coverage results in higher premiums and ultimately higher cost allowances; yet, the purpose of this allowance is to reimburse program delivery expenses.

In this context, USDA has requested the authority to renegotiate the SRA in its proposals for the Farm Bill. Specifically, USDA recommends renegotiating the SRA financial terms and conditions once every 3 years. According to USDA, the crop insurance program's participation has grown significantly since the implementation of ARPA. Because higher participation rates have resulted in more stable program performance, the reinsured companies have enjoyed historically large underwriting gains in the last 2 years of the program. Granting USDA authority to renegotiate periodically would also permit USDA to renegotiate the SRA if the reinsured companies experience an unexpected adverse impact.

## Conclusion

In conclusion, Mr. Chairman, federal crop insurance plays an invaluable role in protecting farmers from losses due to natural disasters, and the private insurance companies that participate in the program are integral to the program's success. Nonetheless, as we mentioned before, we identified crop insurance as an area for oversight to ensure that program funds are spent as economically, efficiently, and effectively as possible. Furthermore, a key reason that we identified crop insurance, as well as other farm programs, for oversight is that we cannot afford to continue business as usual, given the nation's current deficit and growing long-term fiscal challenges.

RMA has made progress in addressing fraud, waste, and abuse, but the weaknesses we identified in program management and design continue to leave the crop insurance program vulnerable to potential abuse. Furthermore, as our work on underwriting gains and losses has shown, RMA's effort to limit cost allowances and underwriting gains by renegotiating the SRA has had minimal effect. In fact, it offers insurance companies and their agents a windfall. We believe that the crop insurance program should be delivered to farmers at a reasonable cost that does not over-compensate insurance companies participating in the program. A reduced cost allowance for administrative and operating expenses and a

decreased opportunity for underwriting gains would potentially save hundreds of millions of dollars annually, yet still provide sufficient funds for the companies to continue delivering high-quality service while receiving a rate of return that is closer to the industry benchmark.

Congress has an opportunity in its reauthorization of the Farm Bill to provide USDA with the authority to periodically renegotiate the financial terms of the SRA with the insurance companies so that the companies' rate of return is more in line with private insurance markets. Such a step can help position the nation to meet its fiscal responsibilities.

Mr. Chairman, this concludes my prepared statement. I would be happy to respond to any questions that you or other Members of the Committee may have.

## Contact and Staff Acknowledgments

Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this testimony. For further information about this testimony, please contact Lisa Shames, Acting Director, Natural Resources and Environment, (202) 512-3841 or shamesl@gao.gov. Key contributors to this testimony were James R. Jones, Jr., Assistant Director; Thomas M. Cook; and Carol Herrnstadt Shulman.

# Related GAO Products

*Climate Change: Financial Risks to Federal and Private Insurers in Coming Decades Are Potentially Significant.* GAO-07-760T. Washington, D.C.: April 19, 2007.

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Chairman WAXMAN. Thank you very much.

I appreciate the testimony of all of you. I want to try and see if I can understand this program a little bit more precisely. Ms. Shames, 40 percent of the money that the Federal Government puts into the program never makes it to the farmers. That amounts to $11 billion worth of benefits designed to go to farmers that are shunted off to middlemen or the insurance companies. Is that right?

Ms. Shames. Yes.

Mr. Waxman. I can't think of another program with this kind of expenditure for delivery costs. The Medicare program spends over 95 percent of its money actually providing medical care. The administrative costs of the Social Security program are less than 1 percent. But 40 percent of the money we spend on the crop insurance program seems to go for the administrative costs, if we are going to be nice about it, just to run the program.

Can you think of another Federal Government program that is as inefficient as the crop insurance program?

Ms. SHAMES. GAO has not ranked the various Federal programs, but I can tell you that we did put the Federal Crop Insurance Program as 1 of 13 programs in need of enhanced oversight. This letter was sent by the Controller General to the new Congress to help the new Congress.

Chairman WAXMAN. Administrator Gould, can you explain to us and to the taxpayers why 40 percent of the costs of your program don't ever make it to the farmers that it is supposed to help?

Mr. GOULD. That seems like a lot of dollars. I would be the first to admit that. But I think you have to stand back and look at the program, that it covers the breadth and width and depth of all the producers in the United States. There is a lot of variability caused by weather in the various crops in the various parts of the country.

The other thing I think that is important is that we are required by statute to deliver the program to all producers in all corners of the United States. So obviously the delivery costs are more than they would be for some programs, and I am sure that accounts for some of the difference.

Chairman WAXMAN. Well, we are dealing with a risk. That is what insurance is all about. But it seems to me what is going on is that the taxpayers are providing three separate and huge subsidies to crop insurers. Ms. Shames, I would like you to walk through how this works. First, crop insurance companies receive the benefit of billions of dollars in taxpayer subsidies to offer crop insurance to farmers. Is that right?

Ms. SHAMES. Yes.

Chairman WAXMAN. And they earn extraordinarily high windfall gains on these premiums. They get much more in premiums than they pay out to farmers when disaster strikes.

Ms. SHAMES. USDA pays for both. Yes.

Chairman WAXMAN. They have earned $2.8 billion in underwriting profits in the last 5 years. Is that right?

Ms. SHAMES. Yes, that is correct.

Chairman WAXMAN. OK. Then on top of these subsidized premiums, the companies also receive billions of dollars in commis-

sions when they sell crop insurance. Basically, these are additional subsidies to cover the administrative costs. Is that right?

Ms. SHAMES. Yes.

Chairman WAXMAN. Over $4 billion in subsidies in the last decade went into these commissions.

Finally, we provide another taxpayer-funded benefit to insurers that we allow them to hand their riskiest policies back to the Federal Government. So the insurance companies are taking the risk, but their riskiest 20 percent of the crops that they cover, they can say to the Federal Government, well, you are going to pay all of it.

Ms. SHAMES. The Government shares a large burden of the risk, yes.

Chairman WAXMAN. How much of the risk do they share in the 20 percent that are the riskiest?

Ms. SHAMES. About 85 percent.

Chairman WAXMAN. About 85 percent. Now, the insurance companies keep a portion of the premiums, but then they are no longer responsible for paying farmers in the event of a disaster. Is that right in those circumstances?

Ms. SHAMES. Right.

Chairman WAXMAN. So it is really a remarkable program. We have so many different ways of subsidizing crop insurers I can barely keep track of it. We have three separate subsidies, it seems to me. Now, what if we just let people go buy private market insurance coverage? I gather that would be so expensive that it would be unaffordable for many farmers. Is that the case, Mr. Gould?

Mr. GOULD. Yes, that would the case. It might not be unaffordable for all farmers, but certainly in areas that are marginal producing areas with problems, where the risk is greater. It would be very expensive for those producers.

Chairman WAXMAN. So we want to make sure that they have this insurance coverage safety net. Is there any competition between insurance companies here? Can the farmers pick one as opposed to another, based on a lower price?

Mr. GOULD. No. The insurance companies all have the same rate. The rates area actually set by the Risk Management Agency. Our goal is a rate of 1.0, so the indemnities paid are equal to the premiums. That is our rating goal. So consequently, the insurance companies compete only on service and areas that they wish to write and deliver the program to the producers.

Chairman WAXMAN. And do most insurance companies compete in the same geographical region? Or do they split up the areas of the country, and some insurance company covers one area and another insurance company covers another area?

Mr. GOULD. Some companies compete more in one area. There may be come that compete in a given area of the United States. Others may specialize in the less, how shall I say, populous parts of the country. But all in all, companies are entitled to write anywhere and everywhere. They actually have to get licenses from different States in which they write, so there isn't a lot of overlap in particular companies.

Chairman WAXMAN. Ms. Shames, is there any other insurance policy for any other potential loss where the insurance companies have so little risk that they really themselves are facing?

Ms. SHAMES. The closest analogy would be for the property and casualty insurance. Of course, the benchmark for that in terms of profitability is about one third.

Chairman WAXMAN. About one third.

Ms. SHAMES. Yes.

Chairman WAXMAN. So if we are going to guarantee insurance, one thing we could do is to say we are going to make sure that the subsidies are not going to be any more than property and casualty insurers.

Ms. SHAMES. It would certainly be a benchmark.

Chairman WAXMAN. And how much money would we be saving if we simply went to that level?

Ms. SHAMES. Certainly hundreds of millions of dollars.

Chairman WAXMAN. If there any fear that you would have that insurance companies wouldn't be able to continue in operation?

Ms. SHAMES. Well, the expenses that they impose are so composed, in other words, in terms of their administrative and operating costs, so I would say that there is some buffer.

Chairman WAXMAN. OK. I thank you very much.

I am going to call on Mr. Davis and the other Members.

Mr. DAVIS OF VIRGINIA. Thank you.

Mr. Gould, the 2007 farm bill proposes a change requiring insurance companies to return 22 percent of their underwriting gains to the Government. What responses have you received from industry and your authorizing committee regarding this proposal?

Mr. GOULD. Well, as we stand back and look at the administration's farm bill proposals, there are a number of proposals in there to rebalance the program. You mentioned the quota share, the net book quota share as one option. There are others about reducing the A&O subsidy to the companies, and also increasing the farmer portion of the premium. All those are designed to have less exposure to the taxpayer.

Mr. DAVIS OF VIRGINIA. I understand that. I am asking how industry has reacted to that, and how the authorizing committees have reacted to that, from your perspective.

Mr. GOULD. From my perspective, I don't think that probably anybody wants to get up and say that they are making too much money. So I suspect the industry is going to react negatively to these proposals, but we think it is an opportunity to go back and re-balance the program and have the American taxpayers' dollars——

Mr. DAVIS OF VIRGINIA. Have you gotten any receptivity on the part of the committee to the proposal? Are they reacting to their constituents in industry?

Mr. GOULD. I am sorry. I am not sure I understand.

Mr. DAVIS OF VIRGINIA. Well, is the committee saying, hey, this is a great idea; we want to write this into the farm bill; or do you think they are listening to their industry who is less receptive to this?

Mr. GOULD. I think, from my perspective, in the view of the USDA, I think they are putting forth their best foot forward to rebalance the program.

Mr. DAVIS OF VIRGINIA. I am asking about the Ag Committees in the House and the Senate. You have your bill. We know the industry.

Mr. GOULD. We have talked to them, but we have not gotten any feedback from them.

Mr. DAVIS OF VIRGINIA. They haven't said, hey, that is a great idea.

Mr. GOULD. They have not come forward with that.

Mr. DAVIS OF VIRGINIA. You have no indication they are going to write this into the bill at this point?

Mr. GOULD. They have not seen the language yet, no.

Mr. DAVIS OF VIRGINIA. They had a hearing on it on Tuesday. What was the reaction of Members to this part? Was there any reaction?

Mr. GOULD. Not on the possibility of the companies. We talked more about the supplemental deductible coverage that is also one of the administration's farm bill proposals.

Mr. DAVIS OF VIRGINIA. And how was the reaction to that?

Mr. GOULD. I would say very favorable.

Mr. DAVIS OF VIRGINIA. OK. The 2007 farm bill proposes to reduce subsidies for insurance company administrative and operating costs by 2 percentage points. The reaction there from the committee members on Ag?

Mr. GOULD. We did not talk about that specifically.

Mr. DAVIS OF VIRGINIA. OK. So that wasn't really addressed at your hearing, it would seem.

Mr. GOULD. No. I think the Ag Committee is waiting to see the language that the administration is going to come forth with, and then they will act or react to that accordingly.

Mr. DAVIS OF VIRGINIA. OK.

Ms. Fong, let me ask you. We know from USDA of the backlog at the Department of Justice hindered the ability to properly prosecute individuals who were committing fraud on the crop insurance program. How does this backlog affect your office's work?

Ms. FONG. Well, these cases can be very, very difficult and complex because they involve multiple parties, lots of different schemes and the need to track that evidence across State lines. And the records are very difficult to find. So what we have found is that the prosecutors need to be educated on the complexities of the program. As a result, we have been very fortunate. We have found in a couple of States prosecutors who are really interested in going after these questions, and we have had some very successful cases.

In other places, we engaged in education and training, and we are currently working with Justice very closely on some major investigations at the national level that we are quite optimistic about.

Mr. DAVIS OF VIRGINIA. OK.

Ms. Shames, how would allowing the USDA to renegotiate the financial terms of the standard reinsurance agreement reduce the monetary waste in the program?

Ms. SHAMES. Well, it gives USDA an opportunity to bring the SRAs closer in line with private industry. We feel that is where the hundreds of millions of savings will be, to try to bring it closer to the industry standard.

Mr. DAVIS OF VIRGINIA. OK. I will just ask one question and everybody can take a stab at it. If you could just make one suggestion as to how USDA could best reduce waste, fraud and abuse in the crop insurance program, what would it be and how would it work? Top priority?

Mr. GOULD. The top priority would probably be to increase our compliance budget and exposure so we could get more compliance, people on the ground; increase our IT budget so we could in fact do more data mining. That has been extremely successful in finding and prosecuting anomalies that show up in the crop insurance world. That would probably be our No. 1.

Mr. DAVIS OF VIRGINIA. Not a change in law, just allow you to do your job, basically.

Mr. GOULD. That is correct.

Mr. DAVIS OF VIRGINIA. Anyone else? Ms. Fong do you have a comment?

Ms. FONG. I think we should look at the basic structure of the program. We need to have more incentives for insurance companies to really make sure that they pay out on good claims. If there are questionable claims, that they really pursue those and look at them. Right now, those incentives I would say are very low, very few.

Mr. DAVIS OF VIRGINIA. Ms. Shames.

Ms. SHAMES. We recommended in our 2005 report that RMA and FSA conduct all these inspections in the fields that were called for. In other words, those fields that were suspected of false claims. USDA had disagreed with this recommendation because they felt they had insufficient resources to do that.

Mr. DAVIS OF VIRGINIA. Thank you.

Chairman WAXMAN. Thank you, Mr. Davis.

Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

I used to represent an entirely rural district. Now, I have a more urban one, but I still care deeply about farmers and their welfare. What we have heard today is pretty disturbing. It sounds like this could be one of the most wasteful programs in all the Federal Government, at least in terms of percentage of money that is not reaching the intended beneficiaries. That is pretty scary right there.

We also have a situation in which the farm bill is up for reauthorization. To my knowledge, that committee has not had a single hearing so far, and there is just a little time left for a witness that is at all critical of this program.

It also seems to be a situation in which the industry has given over $1 million in campaign contributions primarily to Agriculture Committee members. The reform proposals we are hearing, better data mining and things like that, catching fraud, could be interpreted as doing more of the work for these insurance companies. The startling number that I heard was from Ms. Shames saying that the Federal Government still holds 85 percent of the risk here.

Ms. SHAMES. Yes. I should point out that is for the most risky fund.

Mr. COOPER. That is an amazing situation. This sounds like corporate welfare to me. It is the Department of Agriculture, not the Department of Corporate Welfare. I looked last night at a couple of the Web sites for the 16 companies that are in this business. If you look just at the initial page, it looks like small town America, Main Street, little towns, great States. But as you dig into the Web site a little bit, sometimes you will see that these are obscure subsidiaries of multi-billion dollar multinational insurance companies headquartered in Bermuda and God knows where else.

If I were Mr. Gould, I would be trying to manage a situation like this. You point out in your testimony that you are a life-long farmer in northern Illinois. That doesn't interfere with your day job here in Washington? How does that work?

Mr. GOULD. Actually, when I came to Washington, it was a requirement to recuse myself from the farm operation. I have a son back in Illinois that is operating and managing the farm. So this is my full-time position today.

Mr. COOPER. As a farmer or farm owner or former farmer, what sort of crop insurance do you have?

Mr. GOULD. Prior to coming to Washington, I carried primarily the CAT policy. Since coming to Washington, I actually asked my son the last time I was home, I asked him what kind of crop insurance do we have, and we do have a GRIP policy, a gross revenue insurance protection plan. It is a county-based program.

Mr. COOPER. Do you worry as a farmer that you are not necessarily getting a good deal? The taxpayer, according to the chairman's numbers, are paying $19 billion into these sorts of programs, and farmers have gotten $10 billion of that? One of the most inefficient ratios that I am aware of in any Government program?

Mr. GOULD. I think we need to stand back and look at the program in totality. That being that we are as an agency required to insure all parts of the country, each part of the country, and some places are very sparse or high-risk crops. We are still required to provide the coverage for those people and those producers.

Mr. COOPER. I have a limited amount of time. Remember, you represent the U.S. Department of Agriculture. By definition, you cover the country.

Mr. GOULD. Yes.

Mr. COOPER. Do you really need companies headquartered in Bermuda and other places to help you cover the country and to pay them $9 billion or $4 billion for their services? If the Agriculture Department did its job, you wouldn't need this extra layer.

Mr. GOULD. I would like to point out that the companies that you refer to as being headquartered in Bermuda are reinsurance companies. They are the companies that insure the 16 insurance companies in the United States. In the administration's farm bill proposal, we are suggesting that we as taxpayers take some of that reinsurance and keep it in-house, so to speak, so that would certainly reduce the amount of reinsurance opportunities that would go to reinsurance companies.

Mr. COOPER. Mr. Gould, I am not sure you heard Ms. Shames. She was saying that the Federal Government has already retained

85 percent of the risk for these riskiest farms. So you are already the reinsurer. You are just allowing the companies to reap the profits and the commissions for trying to somehow augment the Federal Government's capability. The Federal Government is holding the bag here.

Mr. GOULD. We are proposing to provide or hold back some of the quota share on all the funds, not just the most risky funds. So in fact in total, the program would in fact retain much more of the premium and much more of the risk than is currently the case.

Mr. COOPER. So instead of being the most inefficient program in Government, it might be the second or third most inefficient program in Government?

Mr. GOULD. I don't have a way of ranking or knowing the other programs. I certainly think it would be an improvement for this program and still maintain the goals and objectives as set out by statute.

Chairman WAXMAN. Thank you, Mr. Cooper. Your time has expired.

Mr. Duncan.

Mr. DUNCAN. Thank you, Mr. Chairman. Thank you very much for calling this hearing and calling attention to a very serious problem. I want to say that I agree with everything that my colleague, Congressman Cooper, has just said about this. I have those same concerns. I think anybody that is fiscally conservative would be horrified by what we are hearing here today.

Mr. Gould, how many employees do you have in your agency?

Mr. GOULD. We have a total of 500 employees in the agency, and approximately 100 of those look after the compliance function.

Mr. DUNCAN. The reason I ask that, you know, every time I hear about a Federal agency messing up, which almost seems to be a daily occurrence, if they are ever questioned about it, they always say one of two things. They always say either they are underfunded and need a bigger budget; or they say their computers are out of date and not talking to each other.

And yet, all these Federal departments and agencies are getting far more in funding than a comparable operation in the private sector would get, and all of them have more up to date technology, yet those are the excuses they always fall back on.

When you hear these things like the chairman has said, and Mr. Cooper, about how this program is the most wasteful or one of the most wasteful in the whole Government, does that embarrass you? Is that going to stir you into any kind of action? What are you doing to do in response to this? Are you just going to sit around and wait until we come in and increase your budget? Are you going to go back this afternoon and start doing something about this?

Mr. GOULD. Thank you for the question. We are in I would say an ongoing effort to improve the program. As I have become more familiar with the program, I see some opportunities for improvement. That is an ongoing effort. However, we are limited to some degree by statute what we can do, what we can change, how fast we can change it. Our rating period looks back over a period of time to determine the proper rates.

I would say, maybe contrary to the comments made here about our technology and the things we have to work with, that our budg-

et has not kept up with our needs. We have largely kept pace with the computer program we do have by funding that through salary lapses and things of that nature.

So it has become a challenge and we have to establish priorities. I think we recognize some of——

Mr. DUNCAN. Let me just say this. You are surely not saying the statute now limits you. If you find out this afternoon or tomorrow that some farmer has done something crooked, you are not telling us that you can't do anything about it because of the statute, are you?

Mr. GOULD. No, I am not saying we can't do anything about it. What I am saying is we are limited to some things we can do by statute in how fast we can change and adjust the program. I think as we look forward to the administration's farm bill, that is where we see our opportunity to make changes and improve the program and, as I have said before, re-balance the program in favor of the U.S. taxpayer.

Mr. DUNCAN. You know, we all love and respect the farmers, but there is almost no industry that is more subsidized by the Federal Government, except for the defense industry. We just can't turn farmers into the biggest welfare recipients in the country. It says here that the overall cost to the taxpayer has increased 64 percent since 2000. Those are years of relatively low inflation. Each year ad hoc disaster assistance bills are passed that provided another $8.6 billion since 2000 on top of the regular farm bills. The vetoed Iraq supplemental contained another $3.5 billion in disaster aid.

When you start adding in the subsidies and these crop insurance payments and all these programs that the various agriculture agencies have, I mean, my goodness, it seems like it is almost getting out of hand.

Ms. Fong, you said that the best recommendation you can make is to give the insurance companies more incentive or put more pressure on them to not grant every claim that is made, or the more questionable claims. How do we do that? How do we give them incentive to do that, or put more pressure on them?

Ms. FONG. It goes back to the basic question of who is bearing the risk. Right now, the way the program is structured, the Government and RMA bears the risk for claims having to be paid out. What needs to happen is to have more of an incentive, namely by increasing the amount of risk that the insurance companies bear would give them more of an incentive to really examine the claims that are being filed to determine whether they truly are legitimate claims that should be paid, or whether or not there are reasons why they shouldn't be paid.

Right now, the way the system works, the incentive is for the insurance companies to grant the claim and to pass the risk along to the Federal Government.

Mr. DUNCAN. Was Congressman Cooper correct that there are just 16 insurance companies involved in this business? Can anybody tell me?

Ms. FONG. I believe that is correct.

Mr. DUNCAN. That is?

Thank you very much.

Chairman WAXMAN. Mr. Cummings.

Mr. CUMMINGS. Thank you very much, Mr. Chairman.

This is a hell of a deal. I am serious. I have never seen anything like this. You know, one of the things that frustrates me about being in Congress is that we will have these hearings and everybody says there is something wrong. Republicans say there is something wrong. Democrats say there is something wrong. And guess what? Nothing happens.

We hear Mr. Gould say that his hands are tied. Ms. Shames, are there things he can do now, so that we are not sitting here 5 years from now, with everybody saying, oh, this is so sad, and it is worse in 5 years. What can he do? Let him know what he can do.

Ms. SHAMES. GAO in 2005 issued a report that identified actions that could be taken to reduce the fraud, waste and abuse in the crop insurance program. We made several recommendations. ARPA gave RMA some tools to help it in terms of——

Mr. CUMMINGS. And when was that?

Ms. SHAMES. ARPA was in 2000 and our report came out in 2005. Just to give you a rundown of the status of the recommendations that we made, RMA did implement our recommendation that it should give FSA, the Farm Service Agency, information on a more timely basis, and RMA is doing that.

On the other hand, we also recommended that all the claims that were suspect should be inspected. At the time, we found that only 64 percent of those claims were being inspected. RMA disagreed with our recommendation and they cited insufficient resources for that.

The other thing that we found is that in terms of the data analysis, there are about $74 million in claims that RMA can recoup. Although RMA agreed with that recommendation, it has not implemented it yet. So here is something that can be done on a real time basis.

There are also expanded sanctions that RMA has. RMA has drafted regulations to be able to take advantage of those expanded sanctions, but there are only in draft at this point.

Mr. CUMMINGS. Mr. Gould, did you hear what she said?

Mr. GOULD. Yes, sir.

Mr. CUMMINGS. Can you act on some of those things and tell us if you can, when you will?

Mr. GOULD. Certainly.

Mr. CUMMINGS. Let me try to explain this to you. You know, we have a limited time to act. I notice what agencies do is they wait for the next hearing, which comes a year or two later. So I would like to hear about deadlines, time lines, so that you get something done, a sense of urgency.

So can you do some of those things? If so, when?

Mr. GOULD. Sir, if I might, actually on the regulations, they should be published by the end of May. They have been drafted. They are going through clearance, and we expect them to be out within, I have been told, 3 weeks.

Mr. CUMMINGS. That is one thing we can expect to see no later than June 1st?

Mr. GOULD. No later than that.

Mr. CUMMINGS. All right.

Mr. GOULD. Actually, on a couple of the other recommendations that GAO mentioned, one of them was to share information with FSA. We are doing that. We ran into a problem under the Privacy Act with sharing some of the information. FSA is in the process of publishing a notice to inform producers of the intended use so we can use data mining to attach those entity files that they recommended that we use, and share those between FSA and RMA for data mining purposes. So that is going to be done fairly soon.

I talked to our Office of General Counsel attorney that is in charge of that, and she said as far as she knew, the notice was moving though whatever clearance is has to go through to get to the Federal Register to be published. Again, I would expect that before the end of the month.

I think the only thing I would clarify is the 64 percent of spot checks. It wasn't that RMA disagreed with doing those spot checks. It was FSA said they didn't have the staff to do that. That is something RMA doesn't really have any control over. We would love to see FSA have the staff and resources to inspect every policy that we ask them to review for us.

Mr. CUMMINGS. I see my time is running out. What about that $74 million? She talked about $74 million that we need to be going after.

Mr. GOULD. That was the entity comparison, and actually if you look in the back of the GAO report that was published in 2005, we took exception to part of that. One of the things that we took exception with publishing that number was the assumption was that all of FSA's data was correct and all of RMA's data was wrong. We haven't tested that to see if that is true or not. But that is tied up in the entity files and the Privacy Act issues that I just mentioned.

Mr. CUMMINGS. Ms. Fong, how do these fraud cases usually come to the attention of the Government?

Ms. FONG. We receive information about potential fraud from a number of sources. RMA is one source, if they become aware of it. But most of our referrals tend to come from FSA, the Farm Services Administration, or the State and local law enforcement people. Frequently, informants will come forward and say, hey, I know about a farmer down the road who is perhaps sending in false information; you need to look into it. It will come to us through State and local enforcement.

Mr. CUMMINGS. I see my time is up. Thank you, Mr. Chairman.

Chairman WAXMAN. Thank you, Mr. Cummings.

Just to followup on that point, you didn't mention the insurance companies. They don't come forward and talk about fraudulent claims particularly because they don't have a strong incentive to care one way or the other, do they?

Ms. FONG. I would hate to make a general statement. We receive many allegations and we may have received some from insurance companies. I wouldn't want to rule that out.

Chairman WAXMAN. You did say they have a very low incentive to care when a fraudulent claim is submitted because, after all, it is not coming out of their pockets. Not only that, but they don't want to poison a relationship with a farmer that they want to go back next year and have him sign up for another period of time to take the insurance. Isn't that right?

Ms. FONG. It is true that most of our information comes from RMA, FSA, and local law enforcement.

Mr. HAND. Mr. Waxman? If I might?

Chairman WAXMAN. Yes?

Mr. HAND. There is a requirement under the SRA for the companies to report fraud or suspected fraud. I would agree that we think there is probably some that maybe doesn't get reported to us as timely as it should be. Whether that is because the companies don't feel the case is strong enough or for whatever reason, but we are working with them on that. It is a requirement, though, of the SRA, so if we found them in violation of that, we would take action against them on that basis.

Chairman WAXMAN. I don't think that they are going to be too worried about that, but it sounds like you do have a legal basis to go after them if you find out about it.

Mr. Gould, to be fair to the administration, you have come up with a proposal in the 2007 farm package to change some of these areas of what we are calling waste, fraud and abuse. I am especially interested in proposals that would improve the efficiency and effectiveness of the program and limit waste, fraud and abuse.

Ms. Fong and Ms. Shames, have you had a chance to review the proposals of the Department of Agriculture at the administration? And should Congress be considering other approaches to limiting waste, fraud and abuse?

Ms. FONG. We have reviewed the proposals dealing with the crop insurance program. We generally support them. We think that they would be a good step forward.

Chairman WAXMAN. Ms. Shames?

Ms. SHAMES. We have not done a detailed review, but they seem reasonable. As I said in my statement, we certainly advocate that there be an authority to renegotiate in the SRA.

Chairman WAXMAN. Well, I think the administration is serious about eliminating waste, fraud and abuse. We are more than happy to work with them to do so. I think there are additional changes that ought to be put into place in this program. I want to discuss some of those with the next panel. It seems to me the status quo is quite unacceptable.

I want to say we learned a tremendous amount about this issue from this panel, and I am very concerned about where billions of taxpayers' dollars are going in this effort. One of the things I will be doing after this hearing is requesting a more detailed GAO investigation of the Federal Crop Insurance Program. I know that GAO's investigators can give us important information about how these taxpayer dollars are being spent, and how we can make sure that the crop insurance program is less wasteful. So we are going to certainly work with you.

And then my last comment, since I have been so involved in health issues, Medicare and Medicaid particularly, it is astounding to me when I hear people say we have to give poor people an incentive to hold down wasteful expenditures, so we make them come up with out of pocket costs; we want to give them the incentive really not to get the services, even though in many cases, they may need it.

And here we are giving exactly the other incentive to the insurance companies. I think it is a mistake to blame the farmers. It is the insurance companies that are getting overpaid. How much money does a farmer get? How much of a percentage of his crop losses are usually covered? It is not 100 percent. Is it 50 percent or less?

Mr. HAND. Average coverage runs between 65 percent and 75 percent.

Chairman WAXMAN. Between 65 percent and 75 percent of their losses are reimbursed under this insurance program?

Mr. HAND. Yes, sir.

Chairman WAXMAN. OK. Well, that certainly helps. Maybe we can give them even more, or just save the taxpayers the money if we changed the amount of money that is going to these insurance companies.

I thank you very much. We appreciate your being with us.

We have three votes on the House floor, so we are going to take a recess. I would expect we will reconvene at 11:30 a.m.

We stand in recess.

[Recess.]

Chairman WAXMAN. The hearing will come back to order.

I am pleased to welcome our three witnesses on the second panel. Bruce Babcock is the director of Iowa State University's Center for Agricultural and Rural Development.

Dr. Bruce Gardner joins us from the University of Maryland's College of Agriculture and Natural Resources. Dr. Gardner is also an old Washington hand, having served as USDA Assistant Secretary of Economics under President George H.W. Bush.

They are joined by Steve Ellis, vice president of Taxpayers for Common Sense.

We are pleased to have the three of you here today. Your statements will be part of the record in full. We are going to call on you in a minute, but as I have indicated, all witnesses before this committee do take an oath, so if you would please rise and raise your right hands.

[Witnesses sworn.]

Chairman WAXMAN. Thank you very much. The record will note that each of the witnesses answered in the affirmative.

Dr. Babcock, why don't we start with you? There is a button on the base of the mic. We are going to have a timer for 5 minutes. We would like to ask you if you can keep your statements to around that time. We will extend a little extra time if you need it.

## STATEMENTS OF BRUCE BABCOCK, DIRECTOR, CENTER FOR AGRICULTURAL AND RURAL DEVELOPMENT, IOWA STATE UNIVERSITY; BRUCE GARDNER, DISTINGUISHED UNIVERSITY PROFESSOR, COLLEGE OF AGRICULTURE AND NATURAL RESOURCES, UNIVERSITY OF MARYLAND; AND STEVE ELLIS, VICE PRESIDENT, TAXPAYERS FOR COMMON SENSE

### STATEMENT OF BRUCE BABCOCK

Mr. BABCOCK. Thank you, Mr. Chairman, Ranking Member Davis, and committee members for the opportunity to participate in today's hearing.

I have been continuously and intensely involved with crop insurance since the early 1990's. Despite my experience, I have only recently been able to make a judgment about whether or not taxpayer support for crop insurance is justified. The program is so complicated that it defies quick understanding. But one needs to know how all the pieces of the program work together before an informed judgment about efficient use of taxpayer funds can be made.

The two most credible public policy objectives that have been offered to justify taxpayer support for crop insurance are that purely private markets would not offer farmers enough insurance and that Congress needs a program to eliminate ad hoc disaster assistance packages.

Farmers face significant risk in their farming operations, and crop insurance clearly helps them manage this risk. But examination of the data and available research unequivocally demonstrate that most farmers would not choose to buy the type and level of crop insurance being sold today were it not for the large premium subsidies offered by the program.

This lack of market demand for crop insurance seems odd. Why should farmers have to be enticed with subsidies to buy a seemingly effective risk management tool? The answer is that farmers have other more cost-effective ways to manage their risk. Diversification, off-farm work, use of marketing tools, and adoption of risk-reducing production practices all work to reduce financial vulnerability, as do the commodity programs in the farm bill. So for most farmers, crop insurance is a cost-effective risk management tool only when the cost is dramatically lowered through premium subsidies.

The fact that most farmers will not buy crop insurance without substantial subsidies leaves only the second policy objective as a justification for taxpayer support. Congressional support for crop insurance has been driven mainly by the hope that enough subsidies will induce enough farmers to buy enough coverage to forestall the need for ad hoc disaster assistance. The subsidies given insurance companies, which consist of the administrative and operating reimbursement and underwriting gains, are more than enough to make it worth their while to service farmers' insurance policies.

The surplus subsidies are then paid as sales commissions to crop insurance agents. The resulting commission rates are large enough in most regions of the country to create a strong incentive for agents to work at convincing farmers that crop insurance is in their best interests. Fortunately for agents, it is an easy sell because premium subsidies have been increased to the point where most farmers find it profitable to buy crop insurance.

For a long time, I have misunderstood the role that underwriting gains play in the industry. At first, I thought they were the price taxpayers had to pay to induce crop insurance companies to share in risk. But then I discovered that the actual amount of risk that is being shared is so small relative to the price that we pay that companies are in fact being paid substantially more than the market price of the risk they bear.

So I looked elsewhere for an explanation. I now believe that large underwriting gains paid to companies serve two purposes. First, they are a complicated mechanism to increase the amount of money that can be used to pay agent commissions. Higher agent commissions translate into more insurance being sold, so large underwriting gains are consistent with the objective of getting more farmers to buy insurance.

The second purpose is that underwriting gains do serve the purpose of creating some incentive for companies to combat fraudulent claims. After all, when companies share in losses, which they do to some extent, they have a greater incentive to challenge bogus claims.

The taxpayer costs of using crop insurance as a means of eliminating disaster assistance is significant. Since 2001, the program has cost taxpayers $18.7 billion. Farmers have received $10.5 billion of this amount. The difference is the amount of money that has been used to induce farmers to buy crop insurance and to service the sold policies.

In essence, Federal tax dollars have been used to create an industry for only one purpose: to contract out the delivery of disaster assistance. One way to judge whether taxpayer support for this industry is efficient or wasteful is to compare taxpayer costs of crop insurance with the resulting reduction in disaster payments. I think that the calculus on this question has been made quite easy by inclusion of yet another disaster payment package in the recently vetoed Iraq War funding bill.

I believe that generous taxpayer support for crop insurance has not succeeded in its stated purpose and it is now time to look for another way to help farmers to get through crop disasters. Fortunately, a way forward is now open because the House and Senate Ag Committees are trying to determine what to do with the 2007 farm bill. I would hope that members of these committees are considering proposals for how the farm bill safety net can be integrated with the crop insurance safety net to automatically and directly provide the kind of support that farmers expect when disaster strikes. Both taxpayers and farmers would enjoy the benefits of this type of smart reform.

Again, thank you for this opportunity to share my thoughts about the crop insurance program. I will be happy to answer any questions later.

[The prepared statement of Mr. Babcock follows:]

**STATEMENT BEFORE THE U.S. HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM**

**Hearing on Waste, Fraud, and Abuse in the Federal Crop Insurance Program**
**Thursday, May 3, 2007, 10:00 am**

**Bruce A. Babcock**
**Center for Agricultural and Rural Development**
**Iowa State University**

Thank you, Mr. Chairman, for the opportunity to participate in today's hearing.

The U.S. crop insurance program has two broad public policy objectives: help farmers manage financial risk and eliminate the need for Congress to pass supplemental ad hoc disaster assistance programs. To meet these twin objectives, Congress reformed the program in 2000 with the Agricultural Risk Protection Act (ARPA). For example, President Clinton's statement upon signing the Agricultural Risk Protection Act (ARPA) of 2000 was as follows: "I have heard many farmers say that the crop insurance program was simply not good value for them, providing too little coverage for too much money. My FY 2001 budget proposal and this bill directly address that problem by making higher insurance coverage more affordable, which should also mitigate the need for ad hoc crop loss disaster assistance such as we have seen for the last three years." And in 2006 testimony before the House Subcommittee on Agriculture, Rural Development, Food and Drug Administration, and Related Agencies, former USDA under secretary J.B. Penn said, "One of the overarching goals of the crop insurance program has been the reduction or elimination of ad hoc disaster assistance."

By all accounts, Congress has seemingly succeeded in its objective to help farmers manage risk. Coverage is provided to more than 350 commodities in all 50 states and Puerto Rico. And more than 80 percent of eligible acres are now insured under the program. However, this success has come at a high cost. Current CBO projections indicate that the crop insurance program will cost taxpayers an average of more than $5 billion per year for the next five years, which is about double what the program would have cost without the reform. One might be able to justify this additional cost if the second objective of the program had been met also. But inclusion of $3.5 billion in yet another disaster assistance program in the Iraq funding bill shows that the program has failed in meeting its second objective. Members of the House and Senate Agricultural Committees justify the need for disaster assistance despite large amounts of crop insurance aid because even an expanded crop insurance program cannot provide adequate assistance to farmers in financial stress.

So we today now have an expensive crop insurance program that provides inadequate aid to farmers. Thus when disaster strikes, Congress steps up and provides even more aid. The root cause of this inefficient system is that too much crop insurance money is spent on program administration and not enough is spent on supporting financially-stressed farmers. The remainder of my testimony will explain how we arrived at this situation and

how the program can be reformed to make both farmers and taxpayers better off, eliminate the need for disaster assistance programs, and result in a more competitive crop insurance industry.

Taxpayer Support of Crop Insurance

Since 2001, when the provisions of the Agricultural Risk Protection Act (ARPA) fully came into force, taxpayers have paid $18.7 billion to deliver $10.5 billion in net payments (indemnities paid less farm-paid premiums) to farmers. That is, every dollar in net payments provided to farmers costs taxpayers that dollar plus another 78 cents to deliver. Table 1 provides summary program information since 2001. Taxpayer costs equal Administrative and Operating (A&O) subsidies plus net underwriting gains paid to crop insurance providers plus total indemnities paid to farmers minus farmer-paid premiums. Each of these is discussed in turn.

Table 1. National crop insurance data.

| Year | Insured Acreage (million acres) | Total Premiums (million $) | Total Indemnities | Premium Subsidies (million $) | A&O Subsidies | Underwriting Gains |
|---|---|---|---|---|---|---|
| 2001 | 211 | 2,962 | 2,960 | 1,772 | 626 | 342 |
| 2002 | 214 | 2,916 | 4,067 | 1,741 | 743 | -52 |
| 2003 | 217 | 3,431 | 3,259 | 2,042 | 859 | 378 |
| 2004 | 221 | 4,186 | 3,207 | 2,477 | 869 | 848 |
| 2005 | 246 | 3,949 | 2,351 | 2,344 | 861 | 870 |
| 2006[a] | 242 | 4,362 | 3,415 | 2,680 | 903 | 908[b] |

[a]As reported by RMA as of April 23, 2007
[b]Estimated from year to date loss ratio.

*Administrative and Operating Subsidies*
It costs money to deliver crop insurance. Company salaries must be paid. Agent commissions must be paid. Loss claims must be verified and paid. And regulatory requirements must be met. In 1980, Congress decided that delivery of the crop insurance program should be given to the private sector so that the program could be expanded as rapidly as possible. Companies had an incentive to expand sales because they were essentially paid a sales commission. For each dollar of premium they brought in, companies were given a percentage. Currently companies are paid A&O subsidies equal to about 20.7 percent of total premium. In 2007, total premium may top $5 billion because of high crop prices, which translates into more than $1.04 billion in A&O payments.

By far the largest expense item covered by A&O is agent commissions. Commissions vary dramatically across agents depending on how attractive an agent's customers are to competing crop insurance companies. Agents that have a book of business (their customer base) that generates fewer insurance claims than premium dollars will typically be paid a higher commission percentage than agents who have less attractive books of business. Thus commission rates in the Corn Belt are typically much greater than they are in Texas or North Dakota. Many Corn Belt agents are paid more than 20 percent for each dollar of premium they bring to a company. Companies can

afford these high commission rates in the Corn Belt because Corn Belt policies pay out much less than they generate in premiums. That is, companies obtain the bulk of their underwriting gains from Corn Belt farmers.

The best way to think about how agent commissions are determined is with a simple equation:

Commission = A&O plus Underwriting Gain minus Other Costs

Thus, if underwriting gains are 15 percent, A&O is 20 percent, and other costs (loss adjustment costs, salaries, compliance costs, etc.) total 15 percent, then the commission rate will total 20 percent. If underwriting gains drop to 5 percent, the commission rate drops to 10 percent.

The crop insurance industry argues that they could not cover their costs with lower A&O subsidies or lower underwriting gains. This argument is misleading because it does not account for the relationship between commissions and taxpayer support shown in the above equation. The industry's number one cost—agent commissions—would immediately drop as soon as either A&O or underwriting gains were decreased. This shows that crop insurance agents likely rival farmers as the primary beneficiary of taxpayer support for the crop insurance industry.

*Net Underwriting Gains*

As mentioned above, variations in agent commissions are largely determined by the profits companies believe they can make from different agents books of business. Profits are generated in years in which premiums exceed insurance claims. In these years crop insurance companies get to keep a portion of the difference, which is known as an underwriting gain. For example, in 2004, premiums exceeded claims by $979 million. Companies were allowed to keep $848 million of this difference. In years in which premiums are less than insurance claims, companies may have to pay a portion of the difference, an underwriting loss. In 2002, for example, claims exceeded premiums by $1.15 billion. Companies had to pay the government $52 million of this amount.

The 2002 and 2004 examples nicely illustrate why, on average, crop insurance companies generate additional funding to bid up agent commissions activities. In years in which underwriting gains are positive, companies get to keep a larger proportion of the gain than they have to pay the government in years in which there are underwriting losses. The mechanism by which net gains and losses are determined is the Standard Reinsurance Agreement (SRA).

Companies generate net gains from the SRA in two ways. The first is by determining which of their customers are most likely to generate claims and then giving the premium from these customers and responsibility for any subsequent losses directly to the government. The average customer retained by a company therefore has a better risk profile than the average customer in the overall pool. Thus, average claims from the retained pool will be lower than the overall average, and the company will tend to make money.

However, the overall risk of loss from retained customers is still too large for companies to be willing to take on all losses. Hence the SRA is designed to have the government take on a portion of company losses when claims exceed premiums in

exchange for companies giving the government some of their gains when premiums exceed claims. In exchange for companies taking on some of the risk of the crop insurance program, the government is allowing companies to generate some gains. It is almost as if crop insurance companies are selling taxpayers an insurance policy. In years where crop losses are high, taxpayer losses are reduced because some of the losses are covered by the "policy." The premium that taxpayers pay for this policy are the underwriting gains that companies garner in years where crop losses are small. Whether taxpayers are getting a good deal by this bargain depends on the size of the premium paid in good years relative to the payments received in bad years.

Table 2 summarizes one set of conservative estimates of the potential gains and losses to private crop insurance companies from operation of the current SRA. These estimates are based on loss experience from 1993 to 2005 and likely understate the actual underwriting gains that companies currently expect to make. The table presents four equally likely scenarios regarding crop insurance claims. With $4 billion in premiums, companies should expect to make $425 million per year in net underwriting gains. In exchange for paying companies an average of $435 million per year, taxpayers reduce their loss exposure by $223 million in one year out of four. I doubt that there are many taxpayers who would choose such an insurance policy in their own lives. It seems that program costs would be much lower if the Federal government simply and directly took all the risk from the crop insurance program rather than buying an over-priced insurance policy from the crop insurance companies. The conditions under which this conclusion is valid are discussed later.

**Table 2. Potential gains and losses to crop insurance companies under the Standard Reinsurance Agreement**

| Insurance Claim Scenario | Loss Ratio (Indemnity over Premium) | Ratio of Gain to Total Premium | Total Gain to Companies ($ million) |
|---|---|---|---|
| Very Low | 0.53 | 0.238 | 953 |
| Moderately Low | 0.72 | 0.136 | 546 |
| Moderately High | 0.76 | 0.115 | 462 |
| Very High | 1.28 | -0.055 | -223 |
| Average | 0.82 | 0.108 | 435 |

*Producer Premium Subsidies*

The last taxpayer cost category is premium subsidy. Farmers must pay for crop insurance, but they pay only a portion of the amount needed to cover insured losses. Throughout the 1980s and 1990s, farmers were reluctant to buy enough crop insurance to satisfy Congress. So to get farmers to buy more insurance, ARPA dramatically decreased the portion that farmers must pay. Currently, farmers pay about 41 percent of the amount needed to cover insured losses. This large subsidy means that most farmers will get substantially more back from the program than they pay it.

It is somewhat of a paradox why farmers require such large subsidies to buy a product that substantially reduces their financial risk. But farmers routinely reduce financial risk in a number of other ways. Growing more than a single crop, raising livestock, working off-farm, employing marketing tools, and adopting risk-reducing

management practices—all work to reduce financial vulnerability. In addition, for the lowest-risk farmers, the price of crop insurance may not adequately reflect their risk. So one explanation for this paradox is that for many farmers, the amount of remaining financial risk they face may simply be too small to insure unless the price of insurance is low enough. The current 59 percent average subsidy seems to have reduced the price of insurance to the point where most farmers now consider it worthwhile to purchase. This premium subsidy is now so large that the average farmer in the program can expect a rate of return on producer paid premium of 143 percent.

*Reducing Costs*

The high costs of crop insurance are a direct result of Congressional decisions made in 2000. Farmers, agents and companies have simply responded to the incentives created by ARPA. The hope in 2000 was that by spending more money Congress could save money by not having to pass periodic disaster assistance. But now we have both and it is obvious that the efficiency with which taxpayer money is being used can be dramatically increased through reform of the program.

But waste cannot be reduced by simply reducing underwriting gains or A&O reimbursements. One advantage that is often overlooked in giving crop insurance companies a share of the underwriting gains is that provision gives the companies an added incentive to guard against fraudulent claims. After all, it is costly to verify every loss claim and without vigilance, excessive claims will be filed. Because companies must share in the payment of fraudulent claims, they will have some incentive to combat fraud.

Guarding against excessive claims is required because most crop insurance policies cover against crop or revenue losses at the farm level. But, for most crop insurance policies, when one farm has a loss in a region, other farmers in the same region also suffer a loss. This correlation of losses among farmers is due to the fact that crop insurance claims are most often triggered by systemic events. Examples of systemic events include widespread drought, low farm prices, or excessive heat. Note that these events are also the events that trigger disaster assistance packages in Congress. This coincidence suggests a path that Congress could take to end waste in the crop insurance program while eliminating the need for disaster assistance programs. This path would be for Congress to integrate crop insurance with farm bill programs so that the two work in tandem with each other rather. This could be done by using replacing current farm programs with one of two crop insurance programs: Group Risk Plan (GRP), which pays out when county yield is low, or Group Risk Income Protection (GRIP), which pays out when county revenue is low. Adoption of GRIP would also protect farmers against unanticipated declines in prices. Analysis has shown that adoption of either of these programs would directly transfer risk from the crop insurance program to the Federal government thereby reducing excessive underwriting gains paid to companies. Because losses would be paid out based on county yields, the need for costly verification of farm yields would be avoided. Because such a program would automatically make payments when regional disasters occur, it would serve as a standing disaster program.

There would still be a role for private crop insurance to the extent that farmers were willing to pay for insurance against the risk of losses that would not be covered by the farm bill program. These losses would largely be insurable losses because the

uninsurable systemic losses would be covered by the farm bill programs. If market demand were sufficient, then a private, competitive crop insurance industry could emerge that would supplement the risk management assistance offered by the farm bill. This type of integrated approach would make the best use of public funds.

Chairman WAXMAN. Thank you very much. Excellent testimony. Dr. Gardner.

**STATEMENT OF BRUCE GARDNER**

Mr. GARDNER. Thank you, Mr. Chairman and members of the committee. I appreciate the opportunity to address some issues of waste and inefficiency in the crop insurance program.

I am going to focus on three problem areas: First, crop insurance as related to disaster payment programs; second, the low benefits farmers get from crop insurance subsidies as compared to the cost of the subsidies for the taxpayer; and third, some issues in the land use and environmental effects of subsidized crop insurance.

I should note that I am currently involved with a project for the American Enterprise Institute that has commissioned 21 papers on a range of farm bill topics. One of those focuses on crop insurance. That paper goes into further depth on all three of these issues.

So first, crop insurance and disaster payments. The powerful history here, I think we should go back even to 1938 when we started with subsidized Federal crop insurance after several decades of unsatisfactory experience, basically the losses were too high, but yet still farmers participated in the program. Congress introduced a disaster payments program in the 1973 farm bill, which I think is one of the most interesting experiments we have had in this area.

This program was essentially crop insurance with no premiums charged. This was popular, of course, but the program had high budget costs. It was criticized by the General Accounting Office for encouraging farmers to plant on marginal acreage and for reducing farmers' incentives to take preventive measures against crop loss.

By 1980, President Carter was moved to comment that the disaster payments program had itself become a disaster. In 1981, Congress ended the program, which I think shows that Congress is capable of making adjustments when the evidence is overwhelming that they have to be made.

After 1980, policy moved back in the direction of bigger subsidies on Federal crop insurance. The idea was that ad hoc disaster programs and subsidized crop insurance were substitutes, and that the appropriate establishment of crop insurance would preclude the need for disaster bills.

This hope has not been realized. After boosts in spending on crop insurance subsidies in the mid 1990's and again after 2000, spending on insurance subsidies was still further increased, yet spending on ad hoc disaster payments did not decline, but rather increased further. In 2003 to 2006, Federal budget outlays on both programs together averaged $4.9 billion a year, or about four times the levels of the 1980's.

Was this just because nationwide crop failures were worse? No. Indeed, U.S. crop yields were at or above the trend levels in this period. The problem is more a matter of not being able to convince some farmers to buy even highly subsidized insurance when experience has revealed that a serious disaster will be followed by an ad hoc relief program.

Now, the second thing I want to mention briefly is that benefits and costs of crop insurance, and we have heard a lot about this already, but I think one would have to recognize that even if we do

spend a lot on crop insurance subsidies, that could be worthwhile if the benefits to producers were sufficient.

In fiscal years 2003 to 2005, an average of $3 billion in insurance indemnity payments were paid out to producers. However, while farmers' insurance premiums are subsidized, they still paid an average of $1.5 billion annually during these years to buy their coverage. Therefore, the net benefit from the crop insurance to farmers was $1.5 billion annually.

The Government's cost is the premium subsidies paid plus delivery costs. These costs added up to $4 billion annually in 2003 to 2005. Thus, in this period, the Government incurred $4 in budget costs for every $1.50 in net benefits that producers received. This an inefficient transfer, as we have heard already many times.

The direct payment commodity programs that we have, that spend actually quite a bit more money, are criticized in many ways, but at least the money the Government spends on those programs goes directly into farmers' pockets almost entirely.

Finally, I want to just mention briefly the third topic of land use and the environment. The history of crop insurance and disaster payment programs provides ample evidence that the programs encourage farmers to grow riskier crops and grow them on more vulnerable land than would otherwise occur. An Economic Research Service study estimates that about 1 million acres are devoted to grain and cotton production that would not be in the absence of subsidized crop insurance. More than half this acreage is on the Great Plains.

As one would expect, crop insurance subsidies encourage production in the areas of highest weather risk. These are the same areas that are targeted under the Conservation Reserve Program for taking such land out of crop production and placing it in soil conserving uses. So we have a tendency to be undoing with crop insurance subsidies what we are doing with conversation policy.

So in summary, subsidized crops insurance has an honorable history as an attempt to assist farmers in risk management, but it has proven far too costly in terms of cost to taxpayers per dollar of benefits received by farmers. It has not precluded ad hoc disaster programs, and it has induced production on marginal land.

I believe the Nation would benefit from an end to these subsidies completely and just let crop insurance be sold on a regular market basis like other insurance policies are.

Thank you.

[The prepared statement of Mr. Gardner follows:]

May 3, 2007

**STATEMENT BEFORE THE U.S. HOUSE COMMITTEE ON OVERSIGHT AND GOVERNMENT REFORM**

Bruce L. Gardner, University of Maryland

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before you to address issues of waste and inefficiency in the crop insurance program. I will focus on three problem areas: (1) the relationship between crop insurance and disaster payment programs, (2) the benefits farmers get from crop insurance subsidies as compared to the costs of the subsidies for the taxpayers, and (3) the effects of subsidized crop insurance on land use and resulting economic and environmental costs.

**Crop Insurance and Disaster Payments**

Risk of crop failure is one of the most important problems all producers face. The way individuals and small businesses deal with many risks is through the purchase of insurance policies. Insurance companies indeed have made attempts to sell crop insurance for over a hundred years, but this market has never flourished except when heavily subsidized. One reason is that, while farmers are averse to risk, they are not willing to pay as much for risk protection as that insurance tends to cost. However, a private insurance market does exist with willing buyers and sellers for some hazards farmers face—for example, fire insurance. It appears the main reason insurance against crop failure is more difficult to market successfully is adverse selection – some farms are more subject to crop failure than others, in ways that the farmer is aware of but the insurance company is not. Thus insurance companies find themselves insuring only farms with high risks, which are unprofitable to insure without charging premiums so high as to shrink the market unsustainably.

Given the lack of coverage by commercial insurers, Congress in the 1920s began efforts to create a federal crop insurance program, and starting in 1938 a series of pilot and experimental crop insurance programs was initiated. But like private crop insurance, federal crop insurance policies were purchased by too few farmers if those policies charged premiums that covered the indemnity payments that had to be paid out in years of crop failure. Even substantial subsidies did not result in high rates of participation by farmers except when farmers could foresee crop failure on the horizon. A 1942 study reported that "In counties and years when soil moisture was lacking (in the spring), insurance sold freely. In those same counties the number of contracts dropped as much as 75 percent when soil-moisture conditions presaged a good crop."[1]

During 1939-41 the overall loss ratio in federal crop insurance averaged 1.54, meaning the government paid out $1.54 cents in indemnities for every $1 of farmers' premium payments, including federal subsidy. Forty years later, after a serious attempt in the

[1] J. C. Clendenin, "Federal Crop Insurance in Operation," *Wheat Studies of the Food Research Institute*, Vol. 18, 1942, pp. 229-290.

Federal Crop Insurance Act of 1980 to improve the program, participation did increase, but during 1980-88 the loss ratio still averaged 1.50.[2]

A response to the shortcomings of federal crop insurance was the Disaster Payments Program, introduced in the 1973 farm bill. Unlike area-based disaster programs which make eligibility for assistance contingent on being in a region of widespread crop failure, the Disaster Payments Program made payments to individual producers of program crops who experienced crop losses, wherever they were located. This program was essentially crop insurance with no premiums charged, and as such was popular with producers. The program was available even in counties where production was so risky that their farms had been declared ineligible for federal crop insurance. The program's payments totaled $3.4 billion during 1974-80. It was criticized for encouraging farmers to plant on marginal acreage and for reducing farmers' incentives to take preventive measures against crop loss.[3] In light of these problems, and in hopes that the Federal Crop Insurance Act of 1980 would lead the way to a more efficient approach, the Disaster Payments Program was not re-authorized in the 1981 farm bill.

What we have experienced in the last 25 years, even after further attempt to improve crop insurance in the Crop Insurance Reform Act of 1994 and the Agricultural Risk Protection Act of 2000, is Congress responding to weather-related disasters with special *ad hoc* programs precisely because so many producers were not adequately covered by crop insurance. Then, in hopes of forestalling future *ad hoc* disaster programs, crop insurance subsidies were increased in order to get more farmers to participate in that program. The thought was that these two approaches – *ad hoc* disaster programs and subsidized crop insurance – were substitutes, and that an appropriate establishment of the latter would preclude the need for the former. So far this hope has not been realized. Table 1 shows the relevant data on federal funding for both crop insurance and disaster payments. What is striking is that after the boosts in spending on crop insurance subsidies in the mid-1990s and again after 2000, spending on *ad hoc* agricultural disaster programs did not decline but rather increased further. In 2003-2006, spending on both together averaged $4.9 billion, about 4 times the levels of 1980s. Was this just because nationwide crop failures were worse? No. Indeed, U.S. crop yields were above the trend level in this period. More likely it is a matter of not being able to convince some farmers to buy even highly subsidized insurance when experience has revealed that a serious disaster will be followed by an *ad hoc* relief program.

**Benefits and Costs of Crop Insurance**

Crop insurance subsidies generate benefits for the producers who receive indemnity payments. In fiscal years 2003-2005, an average of $3.0 billion in indemnities was paid

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[2] These data are from records of the Federal Crop Insurance Corporation. See, B. Gardner, "Crop Insurance in U.S. Farm Policy," in D. Hueth and H. Furtan, eds., *Economics of Agricultural Crop Insurance,* Boston: Kluwer Academic Publishers, 1994, pp. 17-44.

[3] See U.S. General Accounting Office, "Alleviating Agricultural Producers' Crop Losses," 1976, and T.S. Miller and A.S. Walter, "An Assessment of Government Programs that Protect Agricultural Producers from Natural Risks," *Agricultural-Food Policy Review*, 1977, pp. 93-103.

Table 1. Federal Expenditures on Crop Insurance and Disaster Assistance Programs.

| Fiscal Year | Millions of Dollars Crop Insurance | Disaster Payments | Sum |
|---|---|---|---|
| 1981 | 249 | 1,030 | 1,279 |
| 1982 | 160 | 306 | 466 |
| 1983 | 334 | 115 | 449 |
| 1984 | 487 | 1 | 488 |
| 1985 | 521 | 0 | 521 |
| 1986 | 504 | 0 | 504 |
| 1987 | 309 | 1 | 310 |
| 1988 | 945 | 37 | 982 |
| 1989 | 945 | 3,915 | 4,860 |
| 1990 | 806 | 158 | 964 |
| 1991 | 772 | 108 | 880 |
| 1992 | 764 | 1,048 | 1,812 |
| 1993 | 1,303 | 927 | 2,230 |
| 1994 | 489 | 2,556 | 3,045 |
| 1995 | 1,440 | 651 | 2,091 |
| 1996 | 1,621 | 115 | 1,736 |
| 1997 | 1,096 | 192 | 1,288 |
| 1998 | 1,374 | 26 | 1,400 |
| 1999 | 1,783 | 2,241 | 4,024 |
| 2000 | 2,175 | 1,482 | 3,657 |
| 2001 | 3,163 | 2,346 | 5,509 |
| 2002 | 3,466 | 411 | 3,877 |
| 2003 | 3,589 | 2,347 | 5,936 |
| 2004 | 3,126 | 1,046 | 4,172 |
| 2005 | 2,699 | 2,575 | 5,274 |
| 2006 | 3,571 | 471 | 4,042 |

Source: Joseph Glauber. "Double Indemnity: Crop Insurance and the Failure of U.S. Agricultural Disaster Policy," American Enterprise Institute, 2007 (forthcoming).

out to producers. However, while farmers' insurance premiums are subsidized, they still paid an average of $1.5 billion annually during these years to buy their coverage. Therefore farmers' net benefit from the crop insurance program was $1.5 billion annually. The government's cost is the premium subsidies paid plus "delivery costs" paid to the insurance companies, which add up to $4.0 billion annually in 2003-05. Thus the government incurs $4.00 in budget costs for every $1.50 in net benefits that producers receive. This is an inefficient transfer.[4]

[4] Joseph Glauber, *op. cit.*, Table 7, provides calculations that show similar degrees of inefficiency in the whole period since 1990.

It might be argued that because farmers are risk averse, the value of having insurance available is higher than the money-value they get from it. However, we have ample evidence to demonstrate that the great majority of farmers will not buy crop insurance at unsubsidized market prices. Therefore it is unconvincing to argue that crop insurance has great non-monetary value to farmers that should be considered a net benefit to them.

**Impacts on Land Use and Environment**

Subsidizing crop insurance influences farmers' use of crop insurance and by the same token can be expected to influence land use related to the riskiness of production. A good test case of such effects was generated by the Disaster Payments Program of the 1970s. This program provided essentially free insurance to producers of program crops, anywhere in the country. In 8 counties of West Texas and Colorado there was a significant acreage of cropland before the Program went into effect, even though production in these counties was so risky that federal crop insurance was not sold in them. In the four years after the introduction of the Program, cropland acreage in these counties increased by 30 percent (in Texas and Colorado counties where crop insurance had been available, cropland acreage increased 20 percent).[5]

Recent increases in crop insurance subsidies are unlikely to have had effects this large on land use, but several recent studies have found evidence of increased crop acreages when subsidized crop insurance is available. A detailed study by economists at USDA's Economic Research Service estimates that as of the first decade of this century an average of 960,000 acres would be withdrawn from grain, soybean, and cotton production in the absence of subsidized crop insurance, with more than half of this acreage from the Great Plains.[6] As with the Disaster Payments Program experience, it is apparent that the main crop acreage induced by subsidized insurance are, as one would expect, in the areas of highest weather risk such as the Great Plains. These are the same areas targeted under the Conservation Reserve Program for substituting soil-conserving practices for crop harvesting, the areas at highest risk of soil erosion when acreage is cropped intensively. So we have a tendency to be undoing with crop insurance subsidy policy what we are doing with conservation policy.

**Summary**

Subsidized crop insurance has an honorable history as an attempt to assist farmers in risk management. But it has proven far too costly in terms of costs to taxpayers per dollar of benefits received by farmers, has not precluded *ad hoc* disaster programs, and has induced production on type of marginal land that conservation policy is paying farmers to hold out of production. The nation would benefit from an end to the program.

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[5] For details, see B. Gardner and R. Kramer, "Crop Insurance Programs in the United States," in P. Hazell, C. Pomerada, and A. Valdes, eds., *Crop Insurance Programs for Agricultural Development,* Baltimore: Johns Hopkins Press, 1986, pp. 195-222.

[6] C.E. Young, M.L. Vandeveer and R.D. Schneff, "Production and Price Impacts of U.S. Crop Insurance Programs", *American Journal of Agricultural Economics* 83 (2001): 1196-1203.

Chairman WAXMAN. Thank you very much, Dr. Gardner.

Mr. Ellis.

**STATEMENT OF STEVE ELLIS**

Mr. ELLIS. Thank you.

Good morning, Chairman Waxman, Ranking Member Davis, Representative Cooper. Thank you for inviting me here to testify on the Federal Crop Insurance Program. I am Steve Ellis, vice president of Taxpayers for Common Sense, a national, nonpartisan budget watchdog organization that has studied agriculture subsidies since our inception in 1995.

I want to take this opportunity to applaud the critical work that this committee is undertaking. The committee's broad portfolio enables it to identify important trends and problems across the Federal Government and to approach programs with an independent and unbiased eye, which is often difficult for committees of original jurisdiction to do. Tellingly, we have not seen this type of oversight hearing in the Agriculture Committee.

The crop insurance program has been an expensive failure. It has failed to end disaster payments. We practically have to pay for farmers to take out insurance. The only winners here are the insurance companies. To put it in perspective, in 2005 insurers got more than $1.7 billion to provide crop insurance, while taxpayers in toto spent $3.1 billion on a program that delivered slightly more than $750 million in payments to farmers.

In 1980, as has been discussed, the Government shifted to private companies to administer and grow the insurance program. Existing crop subsidies were increased even more from 1994 and 2000, and now premium subsidies average roughly 60 percent. That is to say, out of every dollar a private insurer is charging for crop insurance, the farmer is paying 40 cents, while the taxpayer picks up 60 cents. This is an enormous subsidy by any measure.

In addition, the Federal Government pays insurance companies to sell and administer policies. These administrative and operating subsidies run about 21.5 cents on the premium dollar. But the largest A&O expense for the companies is the agent commissions for the policies they sell. Some agents are paid up to 20 percent of the premium on their policies.

In many ways, insurance is like gambling, but in a bizarre twist, the insurance companies are the house and the Federal taxpayer is the perpetual loser. This program has become less about crop insurance for farmers and more about revenue assurance for insurance companies.

This is not to say that farmers are ignorant of their risk. Considering that theirs is one of the world's oldest professions, as Dr. Babcock indicated, farmers have found means to diversify their risk. Crop rotations, irrigation and farming multiple crops are all forms of limiting risk. In addition, many farms receive significant amounts of off-farm income. So it is fair to say that farmers do quite a bit of risk management without any Federal subsidies and without the Rick Management Agency. In fact, these farm level risk management techniques help explain why such large premium subsidies are required to induce farmers to purchase crop insurance.

Federal insurance programs are always inefficient. The Federal Government is always the insurer of the last resort, so insurance programs are foisted upon the Government as a reaction to a perceived market failure, whether real or imagined. But even by Federal insurance program standards, the crop insurance program is incredibly inefficient. Under the current agreement, insurers are able to shift their high-risk policies onto the Federal Government and keep the lower-risk policies in their portfolio, in effect maximizing each company's gain in good years and minimizing losses in bad years.

From our experience, expensive, complex and inefficient is a ready made recipe for waste, fraud and abuse. To tackle waste, fraud and abuse, you have to tackle the crop insurance program's overall expense, complexity and inefficiency. The interplay between subsidies for program crops, crop insurance, and disaster assistance must be examined more closely.

After examining all of these questions, a few clear answers come to the surface. Disaster assistance must be ended. In the latest example of crop insurance failing to end disaster payments, there is $3.5 billion in agriculture disaster spending in the emergency supplemental bill. Since the 1994 expansion of crop insurance premium subsidies, Congress has approved more than $36 billion in agriculture disaster assistance. The chairman of the Agriculture Committee in the House wants to create a permanent disaster title in the upcoming farm bill.

The prospect of disaster assistance undercuts crop insurance and at the very least encourages under-insuring. Farmers, like all businesses, should adequately insure, and if they choose not to, they should not be bailed out by the taxpayer.

Create effective incentives and disincentives. Encourage individual farmers to diversify risk and reduce exposure by providing reduced premiums as an incentive. Premium subsidies should be a reward, not a right. Base revenue insurance plans on total income. Increase mandatory insurance levels and deny crop subsidies for farmers who do not adequately insure. And finally, use Farm Service Agency officials to enforce and police crop insurance policies and enact strong punitive actions for abusers of the program. And last, increase competition.

It is time to scrap the Soviet style planned economy that dominates crop insurance. If there is non-competition, then the value of having private insurers serve as crop insurers evaporates. Since Government currently bears virtually all the risk anyway, shifting some of all of the program background to the Government operations should be an option.

Again, I want to thank the committee for holding this hearing and inviting Taxpayers for Common Sense here to testify. With the farm bill expiring later this year, this is an important time to consider this important issue. I would be happy to answer any questions you might have.

[The prepared statement of Mr. Ellis follows:]

Testimony of Steve Ellis
Vice President, Taxpayers for Common Sense

Committee on Oversight and Government Reform
hearing on
"Waste, Fraud, and Abuse in the Federal Crop Insurance Program"
May 3, 2007

Good morning Chairman Waxman, Ranking Member Davis, members of the Committee. Thank you for inviting me here today to testify on the Federal Crop Insurance Program. I am Steve Ellis, Vice President of Taxpayers for Common Sense, a national non-partisan budget watchdog organization that has studied the agriculture subsidies system since our inception in 1995.

I want to take this opportunity to applaud the critical work this committee is undertaking. The broad portfolio of the Committee enables it to identify important trends and problems across the federal government and to approach programs with an independent and unbiased eye, which is often difficult for Committees with original jurisdiction. This hearing is a perfect example. On Tuesday, the House Agriculture Subcommittee on General Farm Commodities and Risk Management also held a hearing on crop insurance. Two officials from the U.S. Department of Agriculture (USDA) testified at that hearing, but the second panel was made up entirely of representatives of crop insurance companies and agents. To put it in perspective, in 2005 insurers made more than $1.7 billion providing crop insurance while taxpayers spent $3.1 billion on a program that delivered slightly more than $750 million in payments to farmers.[1]

We have already heard a great deal about federal crop insurance today – about waste, fraud and abuse in the program, and about how to hopefully rein it in. After briefly discussing program particulars, I would like to add a taxpayer perspective on the role of federal insurance programs, including how to get the incentives and disincentives right and reduce waste, fraud and abuse.

Jerry Skees, an agriculture economist at the University of Kentucky, said it best when he stated that "Crop insurance is a good idea gone awry. It's expensive, complex and inefficient."[2]

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[1] Gilbert M. Gaul, Dan Morgan and Sarah Cohen, "Crop Insurers Piling Up Record Profits," *Washington Post*, October 16, 2006; A1
[2] *Ibid.*

*"Gone awry"*
In 1980, Congress decided to tap private insurance companies in a bid to expand the crop insurance program. Congress' goal was to end all disaster payments. Crop insurance has no more met its goal of ending disaster payments than World War I met the goal of ending all wars. Just last week, Congress passed an emergency supplemental bill that includes $3.5 billion in agriculture disaster spending. Earlier versions of this disaster assistance for 2005 and 2006 cost more than $7 billion. Since the 1994 expansion of crop insurance premium subsidies, Congress has approved more than $36 billion in agriculture disaster assistance. Building on that costly trend, the Chairman of the Agriculture Committee in the House wants to create a permanent disaster title in the upcoming farm bill.

Commodity payments, crop insurance and disaster payments provide a fiscal security blanket for favored segments of agriculture. But the cost to taxpayers is billions of dollars every year, and the dirty little secret is that a few insurance companies and agents – not farmers - make out like bandits.

*"Expensive"*
The crop insurance program has its roots in the 1930s, but the program we know today was shaped by changes in 1980, 1994 and 2000.[3] In 1980, the government shifted to private companies to administer and grow the insurance program and increased subsidies to entice the companies to offer crop insurance. Subsidies were increased even more in 1994 and 2000, and now premium subsidies average roughly 60 percent. That is to say, out of every dollar a private insurer is "charging" for crop insurance, the farmer is paying 40 cents while the taxpayer picks up 60 cents. This is an enormous subsidy by any measure.

In addition, the federal government pays insurance companies to sell and administer policies. There are 16 companies in the 2007 crop insurance program.[4] These administrative and operating (A&O) subsidies run about 21.5 percent of total premium charges. These funds are used by companies to pay overhead, administer the system, and verify claims. But the largest A&O expense for companies is the agent commissions for the policies they sell; some agents are paid up to 20 percent of the premium on policies. And of course, the companies take away profits (underwriting gains) in good years, which by recent standards are roughly three years out of four.[5]

To put this in perspective, in 2006, the crop insurance program provided nearly $50 billion of insurance coverage to more than 240 million acres, and subsidized premiums to the tune of $2.7 billion.[6] In 2005, the program provided $44 billion in coverage to roughly the same acreage and paid $2.3 billion in premium subsidies.[7] According to a

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[3] Ralph M. Chite, "Agricultural Disaster Assistance," *Congressional Research Service*, October 6, 2006; RS21212.
[4] Available at http://www3.rma.usda.gov/tools/agents/companies/indexCI.cfm.
[5] Bruce Babcock, "Crop Insurance: A Good Deal for Taxpayers?" *Iowa Ag Review*. Center for Agricultural and Rural Development, Iowa State University, Summer 2006; Vol. 12 No. 3.
[6] Federal Crop Insurance Corporation. Crop Year Statistics for 2005 as of April 30, 2007.
[7] Federal Crop Insurance Corporation. Crop Year Statistics for 2006 as of April 30, 2007.

Washington Post analysis, crop insurance companies made a record profit in 2005 -- $927 million. On top of these record profits, the federal government paid them $829 million in administrative fees to run the system. In 2005, farmers got $752 million in payments to compensate for their losses.[8]

Crop insurance companies recognize that they have got a good thing going. The four crop insurance organizations that testified at Tuesday's House Agriculture Committee hearing on the program gave more than $1 million in political contributions over the last 10 years, the vast majority to members of Agriculture Committee.[9]

In many ways insurance is like gambling, but in a bizarre twist, the insurance companies are the "house" and the federal taxpayer is the perpetual loser. This program has become less about crop insurance for farmers and more about revenue assurance for insurance companies.

*"Complex"*

There are many variations of the crop insurance program. Some are based on crop yield using actual farm history or on yield history for the applicable county; still others insure on revenue, whether based on entire farm or county average or a range of expected revenues. One of the most common types of coverage is catastrophic coverage, which pays 55 percent of the price of a crop after losses exceed 50 percent.[10] A USDA Risk Management Agency (RMA) fact sheet notes that they provide policies for more than 100 crops – including everything from carambola trees and cigar wrapper tobacco to Minneola tangelos and winter squash. Another RMA fact sheet lists ten different types of policies, all of which have a variety of provisions.[11]

Despite this complexity, more than 80 percent of the eligible crop acreage is covered. Not to confuse matters, but by different measures only 16 percent of farms purchased crop insurance in 2002, and more than 40 percent of the total U.S. crop value was insured.[12] The difference is that roughly half of all U.S. farms raise livestock, so rarely purchase crop insurance. And among crop farms, the predominant purchasers are field crop producers meaning large farms are insuring – at least at catastrophic levels – while many smaller producers are turning away.

This is not to say that farmers are ignorant of their risk. Considering that theirs is one of the world's oldest professions, farmers have found means to diversify their risk. Crop rotations, irrigation, and farming multiple crops are all forms of limiting risk. In addition, many farms receive significant amounts of off-farm income. So it is fair to say that farmers do quite a bit of risk management without any federal subsidies and without the

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[8] *Supra.* Note 1.

[9] According to a search of opensecrets.org from 1998 to present.

[10] US Department of Agriculture Risk Management Agency Fact sheet on Crop Policies. Available at http://www2.rma.usda.gov/policies/.

[11] US Department of Agriculture Risk Management Agency Fact sheet on Crop Programs. Available at http://www2.rma.usda.gov/data/cropprograms.html

[12] Robert Dismukes and Joseph Glauber. "Why Hasn't Crop Insurance Eliminated Disaster Assistance?" *Amber Waves*. Economic Research Service, U.S. Department of Agriculture. Volume 3, Issue 3.

Risk Management Agency. In fact, these farm-level risk management techniques help explain why such large premium subsidies are required to induce farmers to purchase crop insurance.

The farms most likely to purchase crop insurance are those where more than half of the total household income comes from the farm. In fact, in 2004 nearly 80 percent of corn, soybean, wheat and cotton acres were insured at some level. This represents four out of the big five program crops (rice is the fifth and 70 percent of rice acres are insured). So the crops that are the most heavily subsidized under the current farm bill are also the most heavily insured – by heavily subsidized insurance.[13]

*"Inefficient"*

Federal insurance programs are always inefficient. The federal government is always the insurer of last resort, so insurance programs are foisted upon the government as a reaction to a perceived market failure, real or imagined. Even without considering that Uncle Sam insurance is a business failure waiting to happen, the federal government fights its challenges with one or both arms tied behind its back: setting rates, providing coverage are political calculations, and of course, no one ever gets kicked out of a program for being a bad risk.

Any discussion of federal insurance programs like NFIP, TRIA or crop insurance being actuarially sound is laughable. There is no 18-year-old boy in a red Ferrari in the federal insurance programs. Everyone is a 40-year-old mother in a minivan. Besides, there is no incentive or requirement to charge premiums enough to develop a credible catastrophic reserve or reinsurance fund. In federal insurance programs, the U.S. Treasury is the catastrophic reserve, and the U.S. taxpayers are the reinsurers.

But even by federal insurance program standards, the crop insurance program is incredibly inefficient. The flood insurance program charges ridiculously low premiums and contains indirect subsidies, whereas over half of the tab for crop insurance premiums is picked up by the federal government. Adding to the costs, the government negotiates how to split gains and losses across the system in the Standard Reinsurance Agreement. Under the current agreement, insurers are able to foist their high-risk policies onto the federal government and keep the lower-risk policies in their portfolio – in effect maximizing each company's gain in good years and minimizing losses in bad years. Remember, in 2006 companies returned record profits that were only 12 percent higher than what they received in administrative payments. Crop insurance is a total sucker bet for taxpayers.

Removing higher-risk policies from insurers' portfolios reduces incentives to work with farmers to mitigate risks and plan for loss years and to effectively monitor policies for fraud. In addition, the system of subsidies and paternalistic federal attitudes send the wrong signal to farmers. There is no real incentive to minimize risk, and even worse, there is no real disincentive for higher risk activities like farming on marginal land. In fact, maximizing the likelihood of loss is actually a tactic for those abusing the system.

[13] *Ibid.*

*Waste, Fraud and Abuse*
Expensive, complex and inefficient is a ready-made recipe for waste, fraud and abuse. Much of the recent successes at nabbing individuals milking the crop insurance system came through stepped up enforcement and data mining to identify anomalies. But there is much more that can be done.

Recent USDA IG reports to Congress highlighted a North Carolina corporation that used false documents to obtain more than $9.28 million in crop insurance payments for tomatoes and sought an additional $3.8 million in payments as well. In another case, an Iowa family defrauded the government in attempts to obtain $3.3 million of agriculture payments. RMA also overpaid five producers nearly $400,000 by overestimating the yield from their crops.

A 2005 radio series highlighted attempts to harvest taxpayer dollars from the crop insurance system. One story highlights the fact that you don't have to cheat on forms to make a quick buck out of the crop insurance system; farming is so fickle that you can just sabotage your crop to collect a check. In this case, which the IG pursued but never prosecuted, farmers insured 6,600 acres of watermelons in South Texas. None of the 19 farmers, who were recruited by the insurance agent's son, had any experience growing watermelons. Not surprisingly, the crop failed and those 19 farmers received $5.5 million in insurance payments. Before the watermelon program was closed, $47.8 million insurance claims were paid, representing a full 75 percent of the insured liability.[14]

Unfortunately, we could go on.

To tackle waste, fraud and abuse in the Crop insurance program, you have to tackle the program's overall expense, complexity and inefficiency. Rather than just augmenting the program into a large farm revenue assurance scheme as the Administration and others are proposing (and that crop insurers oppose), Congress should fundamentally re-evaluate the program itself. The interplay between subsidies for program crops, crop insurance and disaster assistance must be examined more closely. Why are many farmers reluctant to purchase adequate insurance coverage? Is it because they diversify their risk or self-insure, or rely on annual disaster assistance giveaways? With 80 percent of eligible acreage enrolled, farmers obviously know the system; do we actually need insurance agents to sell the policies?

Agents are a significant source of overhead costs. The premium subsidies are largely one-size fits all. If you started purchasing crop insurance in the early 1990s, you saw your premiums steadily decline as the federal subsidy increased to get more people into the program. Shouldn't the incentive be to bring more farmland into the program not subsidize those already purchasing insurance? Should there be a requirement to fully insure one's crops in order to be eligible for crop subsidies or disaster assistance?

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[14] John Burnett. "Farm Fraud and The South Texas Watermelon Disaster." National Public Radio. November 14, 2005. Available at http://www.npr.org/templates/story/story.php?storyId=5010092

After examining all of these questions a few clear responses come to the surface:

**Disaster assistance must be ended.** The prospect of *ad hoc* disaster assistance undercuts Corp insurance and at the very least encourages underinsuring. Farmers, like all businesses, should adequately insure, and if they choose not to they should not be bailed out by the taxpayer.

**Modernize Crop Insurance.** Some of this is ongoing; data mining and mapping tools have helped increase enforcement and catch abusers. But even beyond that, farmers are among the most technically savvy business men around and with 80 percent of the eligible acreage in the program, farmers know what is available. Agents and their costly fees should be phased out in favor of the internet for crop insurance sign-ups.

**Create effective incentives and disincentives.** Encourage individual farmers to diversify risk and reduce exposure by providing reduced premiums as an incentive. Premium subsidies should be a reward, not a right. Base revenue insurance plans on total income. Increase mandatory insurance levels and deny crop subsidies for farmers that do not adequately insure. Use Farm Service Agency officials to enforce and police crop insurance policies and enact strong punitive actions for abusers of the program.

**Increase competition.** It is time to scrap the Soviet style planned economy that dominates crop insurance. The Standard Reinsurance Agreement must be redrafted to introduce greater competition and innovation in the marketplace. If there is not competition then the value of private companies servicing crop insurance evaporates, and since government currently bears virtually all the risk anyway, shifting some or the entire program back to government operation should be an option.

Again, I want to thank the Committee for holding this hearing and inviting Taxpayers for Common Sense here to testify. With the farm bill expiring later this year, this is an important time to consider this important issue. I would be happy to answer any questions you have.

Chairman WAXMAN. Thank you very much for your testimony.

I am trying to think through how we can accomplish the goals that were set out in the creation of this program, and do it in a way that makes the most sense.

The first goal was to stop the Government from having to pay after the damage has already been incurred, because the Congress is very softhearted and we hate to see disasters, and people suffer, so we always come in afterwards. I gather that none of you thinks this crop insurance subsidy program has kept us from coming in with relief after the damage is incurred to add to the insurance payments. Is that a correct statement? All of you are shaking your heads.

Mr. Ellis.

Mr. ELLIS. Absolutely. We spent billions of dollars since we increased the subsidy, so clearly it is not even our opinion. It is reality, Mr. Chairman.

Chairman WAXMAN. What is the market failure here? If a farmer wanted insurance in the private market, one would think he could go out and buy it. Now, the argument was made that it is just too expensive. Farmers can't afford it, so we have to help them buy this insurance. If I understand Dr. Gardner's testimony, you don't think that farmers always want this insurance even if it is affordable. Of course, if we are paying for it, they will take it.

Is there a market failure? Or is there just not really a good enough market for people to buy this insurance? Why should the Government substitute our judgment over that of the farmer?

Mr. GARDNER. Well, I would say I agree with you. There is no pervasive market failure. You see problems with markets in insurance of all kinds. The most difficult one I think in crop insurance is sometimes the farmers have a better idea of their situation and know more than the insurance company does, and you have an adverse selection problem.

But the Government has no solution for that problem, and in fact probably does less well at dealing with it than the private insurance companies do. So I don't see a market failure. I think that good evidence of that is in other areas where farmers bear risks, they do buy hail insurance; they buy fire insurance; they buy liability insurance just like any other citizen does. It is unsubsidized and the market works.

Chairman WAXMAN. Dr. Babcock, you don't seem to go as far as Dr. Gardner in suggesting to eliminate the program and letting the market work as well as it is going to, letting the farmers make a decision. What would you do instead? Do you think there is still a purpose for a crop insurance program?

Mr. BABCOCK. I think the evidence is clear that farmers will not buy the kind of coverage that is needed when this one out of whatever year event occurs, and a true disaster hits. So that when that occurs, there is going to be pressure to have some sort of an assistance program after the fact. I don't think it is sufficient just to be able to say, well, you didn't buy insurance so we are not going to help you. I think that ignores political reality.

Fortunately, though, we have something called the farm bill that is supposed to be providing a safety net to farmers. Why not just design that farm bill in such a way that it automatically would di-

rect payments to regions that would in fact deliver the aid when it is actually needed? I think that smart reform of the commodity policy can create a safety net that would do away with disaster assistance and would take on much of the risk of the crop insurance at the same time.

Chairman WAXMAN. So you would use Federal funds to set up a pool of money to compensate farmers when a disaster occurs. Is that right?

Mr. BABCOCK. That is right. It would be automatic. Farmers would know that they are getting it, and would adjust their operations accordingly. I would not do it at the individual farm level, because that means that they are going to be farming for the program. Rather, I would do it when a disaster hits. It is likely that almost all farmers in a county, for example, would suffer that same loss. And so I would do it at the county level.

Chairman WAXMAN. So you would have a Government program, and then eliminate the private insurance completely.

Mr. BABCOCK. Mr. Gould said that his son had purchased something called GRIP, group risk income protection. Basically, if I had a way of designing a policy, I would have the Federal Government, through the farm bill, basically offer that kind of a program to farmers as a replacement for the subsidy programs they have now. Then I would allow the crop insurance industry to write supplemental coverage on top of that would cover individual farm-level risks, and then let the private market offer that if farmers really need additional risk protection. And let the market decide how much risk protection they need.

Chairman WAXMAN. How much would you cover? What percentage of the loss would the Government insurance program cover?

Mr. BABCOCK. At the county level, which is different than the farm level—at the farm level, it would not cover anything for free. It would be up to the farmer to decide how much individual farm-level coverage they bought. Let the market determine that.

At the Federal Government level, it would be on the order of you have at least a 10 percent drop in let's say county yield before payments would commence. So you would have a 10 percent deductible.

Chairman WAXMAN. Have any of you looked at possible competition? Is there some way to give incentives for competition and let the private insurance companies compete for the business, and then let the farmer decide if he wants to buy one policy as opposed to another? If he doesn't want go with any, it is his or her choice.

Dr. Gardner.

Mr. GARDNER. Well, I am not an expert on the ins and outs of the insurance industry, but your question reminds me of an approach that Senator Lugar had introduced in the farm bill discussions in the Senate Agriculture Committee several times, which is in order to help farmers with their risk management problems, have the Government just provide a general subsidy, as we do along the lines Bruce was saying, but let the farmers decide how to spend it. They will have the kind of money they now get from support programs, but maybe not quite so much, and let them decide what to buy. Then the competition will arise.

Who can satisfy the farmers' real needs for this protection in a market of competition, not only with insurance, but for a while they were even county or area-like yield contracts that you could buy on the Chicago Board of Trade. There are a number of ways, a number of mechanisms that could provide contingent assets that increase in value when bad things happen. I would say I just wouldn't want to limit it to crop insurance. Let the whole range of risk management tools be made available.

Chairman WAXMAN. Thank you.

Mr. Davis.

Mr. DAVIS OF VIRGINIA. I want to ask what happens if we in the ag bill this year just abolish the program? How would the market respond if we abolished the Federal subsidies? Would the private markets react? How would the farmers react to it at that point? And what would be the result? We always have the right to come in if someone were hard hit and give them the appropriate payment.

Mr. GARDNER. Are you referring to all the commodity programs?

Mr. DAVIS OF VIRGINIA. No, just this.

Mr. GARDNER. Just this one. Well, what would happen right away, of course, is it would be a big upheaval in the crop insurance industry. What would happen to farmers is they would have to figure out what is being offered very quickly.

Mr. DAVIS OF VIRGINIA. I am just asking for a prediction of the market. Somebody would somewhere offer some insurance.

Mr. GARDNER. Yes, I believe they would, but the market would——

Mr. DAVIS OF VIRGINIA. It would save the taxpayers a lot of money, at least on the front side. If you had a bad year, we may come on the backside and end up with some subsidies that we hadn't intended. I don't now the answer to that, which is what I am asking.

Mr. BABCOCK. I will make a prediction of what would happen. I think that if the insurance companies were to offer the same products without the subsidies, that farmers would immediately go and buy GRP, group risk protection. It is an area yield. It is very cost-effective. And then they would buy private hail insurance on top of that. At least in my area of the country, the hail insurance often strikes an individual farm, but not the county. So the GRP would cover them very cost-effectively for a very small amount of money, then hail insurance would cover them for their primary other risk, other than drought.

Mr. DAVIS OF VIRGINIA. Would they be out of pocket more than they are?

Mr. BABCOCK. About the same, basically, because right now the system is set up to drive farmers to buy the most expensive policy they can, because agents get paid more, the Federal subsidy goes up, the more money that farmers pay. So in fact, they are incentivized to buy the bells and whistles policy.

Mr. DAVIS OF VIRGINIA. Just let the market system work here, is what you are saying. It would respond appropriately and the Federal Government would be out of it and we would save taxpayers' dollars and you would have about the same coverage for the

same cost, or close to it—not the same coverage, but you would have adequate coverage.

Mr. BABCOCK. You would have cost-effective coverage that farmers, I think, would fill the needs of what farmers demand.

Mr. DAVIS OF VIRGINIA. Mr. Ellis, do you have any prediction of what would happen?

Mr. ELLIS. No. I would absolutely agree with the way you are going on this. I think that in the last decade or 15 years, the insurance sector, not just crop insurance, but really the insurance sector writ large, has dramatically changed, basically after Hurricane Andrew, where they have been able to securitize risk. You can trade risk. The reinsurance market is quite large and significant. So there has been a dramatic change in the insurance industry that I think that if we allowed that to have more of a competition for crop insurance, that would definitely drive that.

And then the other issue here is that right now, farmers are being in essence bribed to buy crop insurance. We are paying 60 percent of the premium to try to get them to buy crop insurance.

Mr. DAVIS OF VIRGINIA. They can't afford not to.

Mr. ELLIS. Right, right. So then it is just a question of if you remove that, and they realize that they are going to have to take matters into their own hands, I think that some of these things more designed to their needs, as Dr. Babcock has indicated, those type of policies will start to percolate out. The insurance industry is a business. They are going to make money and there are ways to make money. I always point out, Liberace could insure his fingers, so just about anybody can insure just about anything. It just depends on what the cost is.

Mr. DAVIS OF VIRGINIA. That is exactly right. But reform is unlikely to come out of the Agriculture Committee, isn't it?

Mr. ELLIS. They are certainly not a reform minded institution as far as making big changes. That actually does get to some of Dr. Gardner's points as well, which is what Agriculture has talked about is the three legged stool. You have crop insurance; you have disaster payments; and you have crop subsidies, the program crops. I think that really you have to look at all three of those because they do interrelated, and the different issues of them drive certain policies. People are buying certain types of crop insurance because of the program subsidies, and these all have interrelated effect.

So I think that while I definitely agree that getting rid of crop insurance makes a lot of sense, I think you want to look at the other issues within the farm program. We are certainly not a big fan of the commodity title, Title I in the program crop subsidies, and it would be worthwhile to look at that and how to make those work better together.

Mr. DAVIS OF VIRGINIA. I am not advocating. I am just asking. I think we need to ask the question, how would the markets respond on their own. We don't allow them to respond on their own because you have so many of these different Government gimmicks along the way. That is my question.

Thank you, Mr. Waxman.

Chairman WAXMAN. Thank you, Mr. Davis.

Mr. Cooper.

Mr. COOPER. Thank you, Mr. Chairman.

During the previous vote, I talked to a colleague that is on the House Agriculture Appropriations Committee. Apparently, USDA testified there yesterday that all they needed was more staff money for raises, nothing for compliance, and a little bit more money for IT. So they don't seem to have gotten the message that reform is necessary.

Help me understand, Dr. Babcock, hail insurance and GRP insurance. Is that completely private and unsubsidized? How does that work?

Mr. BABCOCK. No. GRP is a federally subsidized and reinsured, just like a regular crop insurance product. What it was was an idea of trying to get farmers not to worry about so much compliance issues because their losses would be paid by the county.

Hail insurance was a robust private insurance market up until ARPA subsidies in 2000 were greatly increased. Then farmer participation in hail insurance went down. Essentially, the private sector got crowded out because the subsidies for multi-peril crop insurance became so large that hail insurance is a proven private product that can be offered privately.

Mr. COOPER. So the Government in 2000 helped kill this private sector offering, or reduce it substantially.

Mr. BABCOCK. It reduced it. It is still offered, but the demand for it has gone down because the multi-peril products cover essentially a lot of the same risk.

Mr. COOPER. In your testimony, when you predict that under current CBO protections, crop insurance programs will cost taxpayers an average of more than $5 billion per year over the next 5 years or $25 billion, does that include GRP insurance?

Mr. BABCOCK. It does, but not very many farmers buy GRP because it is a very low cost program. If the Government is paying 60 percent of the premium, why would you want to minimize your own expenditure? So essentially the fastest growing crop insurance product out there is this GRIP product. GRIP-HRO it is called. It is an acronym. It is the most expensive product out there. It is the fastest growing product, and not as surprising, it is the one with the highest premium.

Mr. COOPER. A few months ago, I had the pleasure of questioning the Secretary of Agriculture in a Budget Committee hearing. I asked him how many field offices he had. He said 3,800. I asked how many of those offices were located in counties that no longer had any farms period, and he said he would get back to me on that. But that is one of the most extensive networks of Government offices for any Federal agency.

One of you suggested in your testimony, it might have been Dr. Gardner—no, I think you suggested actually ending the program. I think it was Dr. Babcock that said maybe we should link participation in government subsidy programs with purchasing coverage, because if we have 3,800 offices and farmers have to go visit those offices anyway, that is a point of sale that is infinitely more efficient than 20 percent commissions that are being paid by these 16 crop insurance companies.

Does something like that make sense? If you want to participate in the subsidy programs, you have to do something yourself to insure against the risk.

Mr. GARDNER. That kind of things has been tried. We did that after some of the disaster payments programs, to require filings in one of the commodity programs to have some crop insurance coverage.

Mr. COOPER. Another thing that struck me, and the Washington Post pointed this out, that recipients of disaster payments, that information is private. No one is allowed to know. Why do you have a right to privacy when you get a large Government check like that due to hail or flood or drought, or whatever?

Mr. GARDNER. I don't know.

Mr. COOPER. So that is something Congress did on its own, to hide the recipients of these payments. It is not like their neighbors don't know, because it is pretty apparent what is on your farm.

It strikes me that there are number of folks who like farming the land, and there are some folks who like farming the taxpayer, and farming the taxpayer is probably a more lucrative undertaking.

I want to quote for a second from the Post article talking about a Kansas farmer, Mark Orebaugh. It says, "For Mark Orebaugh and most Kansas farmers, the Federal insurance is 'a good deal.' In the past 4 years, he has paid $81,730 in premiums, but collected $295,796 in claims, or $3.62 for every dollar he put in. That is higher than the State average, but Orebaugh farms on the western side of Kansas, where water is scarce and much of the farmland is not irrigated." It goes on to say, "There is just no water here. We probably should never have developed these fields when we did 30 years ago, because the water table was declining."

So that is Dr. Gardner's point, a lot of marginal land that really shouldn't be farmed is being kept in production at taxpayer expense, just due to the existence of these subsidy programs. But here is a man whose has four times more money than he paid in in premiums, because of farming the taxpayer.

So land almost becomes irrelevant if you can gain the premiums and the payouts right, and the weather goes along, you can do quite well.

Mr. GARDNER. I would just like to say, though, that is it no picnic farming those really risky areas. I wouldn't want to do it. So I wouldn't put it so much that the farmers in those areas, like in the old disaster payments program, where it was quite clear that there were counties that weren't even eligible for the subsidized Federal crop insurance, were eligible for the disaster payments program, and wheat acreage rose substantially in those counties.

I don't think those people had any picnic with this. They are just following what the incentives tell them to do.

Mr. COOPER. I am not saying it is a picnic, but it is the subsidy program, the Government, that is keeping them tied to this hard work and this tough life.

Mr. GARDNER. I agree.

Mr. COOPER. So without the Government intervention, he might have a better job somewhere?

Mr. GARDNER. Exactly.

Mr. COOPER. Or be a farmer in an area with a water table and water and things like that are presumably necessary for growing crops.

In testimony yesterday in the House Ag Committee, representatives of the crop insurance industry said that the administration's reform proposals, as weak as they are, the industry witness described them as "draconian," and they would drive insurers from the market, resulting in serious and adverse consequences.

Do you agree that the administration's reform proposals, as mild as they are, would have such an effect?

Mr. ELLIS. No, I would say that they are more dithering around the edges, rather than actually draconian. They talk about driving them from the market. I would question, what market? Really, all the rates are established. There is virtually no competition among the companies.

So essentially, it isn't really a market at all to be driven from. So then it is really more about we have to fundamentally reexamine, which is what this committee is doing, and what these questions have certainly been touching on, and what the witnesses have testified to, that we have to fundamentally reexamine the way this program is being delivered and envisioned, and how we are going to do our agricultural supports, and in what form, and how little or how much.

The administration's proposal doesn't go nearly far enough to do any of that sort of thing. I imagine they will cut into the profit margin of some of these companies, but really it is a pretty fat profit margin.

Mr. COOPER. I see my time has expired. In prior testimony from the GAO, I think profit margins were about triple a normal casualty business. That seems to be pretty good.

I thank the chairman for the time.

Chairman WAXMAN. Thank you, Mr. Cooper.

Could you elaborate, Dr. Gardner or any of you, on this cross purpose of subsidizing insurance and therefore encouraging them to grow crops that are interfering with the Conservation Reserve Program, and causing environmental problems. Dr. Gardner, do you want to elaborate more on that?

Mr. GARDNER. I can't elaborate too much more. This hasn't been intensively studied, but just to take an example. There have been some academics trying to look at what the effect to the Conservation Reserve Program has been on actual acreage conserved and acreage planted. They always find some slippage in this, that even though you enroll 36 million acres in the Conservation Reserve Program, but you don't see the corresponding decline in crop acreage. This means somebody is increasing crop acreage somewhere else as land enters the Conservation Reserve Program.

Exactly all the reasons for that are not clear, but I think it is quite clear, and the ERS study that I mentioned is the only one I know that really tried to quantify that. They found an estimate of 960,000 acres, almost one million acres, in cotton and grain that would not otherwise be in cotton grain—this was in the early 2000's—because of the existence of the crop insurance program. You can't say which acres those are, but there are clearly more than half of them in the Great Plains, and that is where your more risky conservation reserve type program land is. So there has to be some connection. To quantify it exactly, I can't go that far.

Chairman WAXMAN. Well, let me invite you, those who think that there is maybe an alternative other than abolishing the program, which I think politically would cause a firestorm, to submit any other ideas. Submit to us some other ideas that could, one, integrate the insurance programs and might be something we can present in this farm bill to the Agriculture Committees or to our colleagues on the House floor. So please feel comfortable to submit it to us. We would like to look at it.

Mr. Davis, anything further?

Mr. DAVIS OF VIRGINIA. I appreciate all the witnesses.

Chairman WAXMAN. Mr. Cooper, you have been very, very helpful and I thank you so much for being here.

We stand adjourned.

[Whereupon, at 12:20 p.m. the committee was adjourned.]