

**Analysis of the Report to the Secretary of
Agriculture by the Office of the Inspector General
on Federal Crop Insurance
Volume I**

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**This report is presented in two volumes.
Page number references in this Volume I
are to Volume II.**

Introduction

- **PHB Hagler Bailly has reviewed the recent report on the federal crop insurance program prepared by the Office of the Inspector General, U.S. Department of Agriculture.**

- **We conclude that**
 - ▲ **Contrary to the findings of the OIG report, private sector participation has enabled the federal crop insurance program to meet important goals set for it by Congress (pp. 16-21).**
 - ▲ **The report reflects flawed methodology and reasoning, and presents conclusions and recommendations that cannot be relied upon (pp. 21-34).**
 - ▲ **Turning crop insurance delivery over to the Farm Service Agency would irreparably harm the program (pp. 35-56).**
 - ▲ **Maintenance in some form of the current public/private partnership is the only feasible way to achieve program goals (pp. 56-65).**

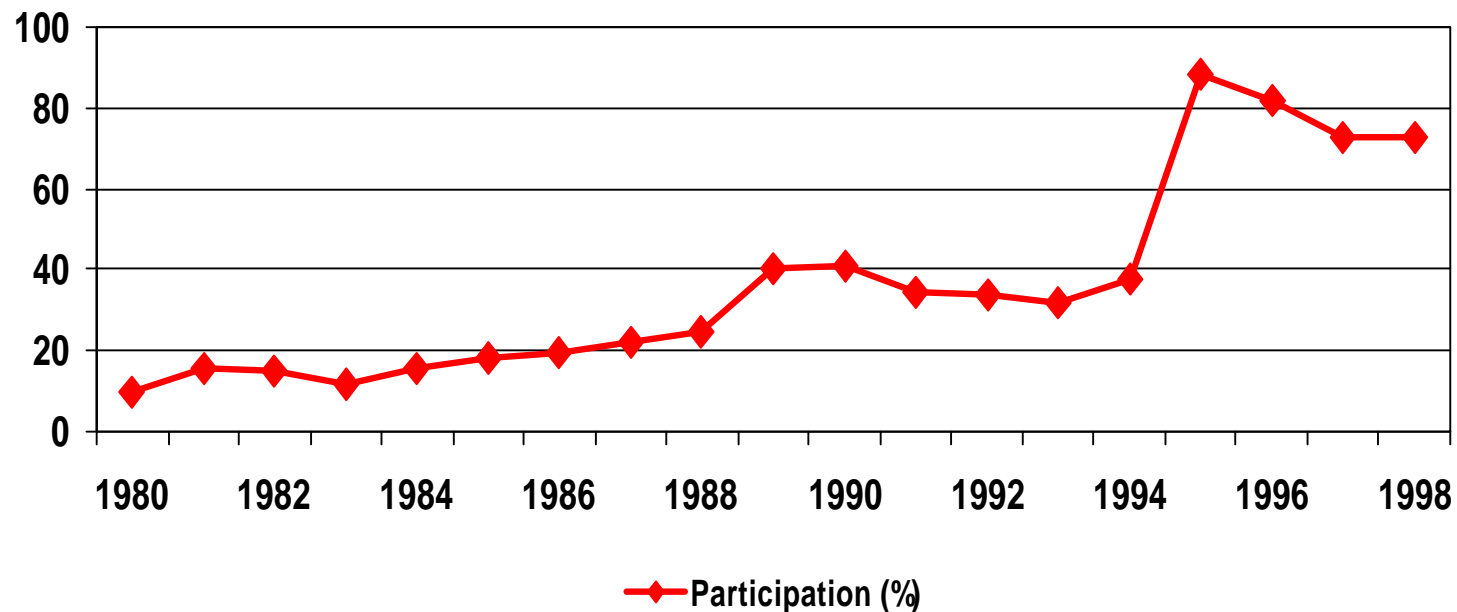
**Private Sector Participation Has
Enabled the Program to Meet
Important Goals
Set for It by Congress**

The program is meeting important goals set for it by Congress

- In 1980, with the passage of the Federal Crop Insurance Act, Congress established the current public/private partnership that is the basis for the crop insurance program (p. 14).
- Congress established as a goal a crop insurance program that would be universally available and that could serve as an alternative to ad hoc disaster assistance (pp. 14-15).
- Federally supported crop insurance is now widely relied upon by farmers, lenders, and the agricultural community as a principal risk management tool, and a primary form of protection against natural disasters and other perils (p. 16).

Participation in the program by eligible farmers is now widespread

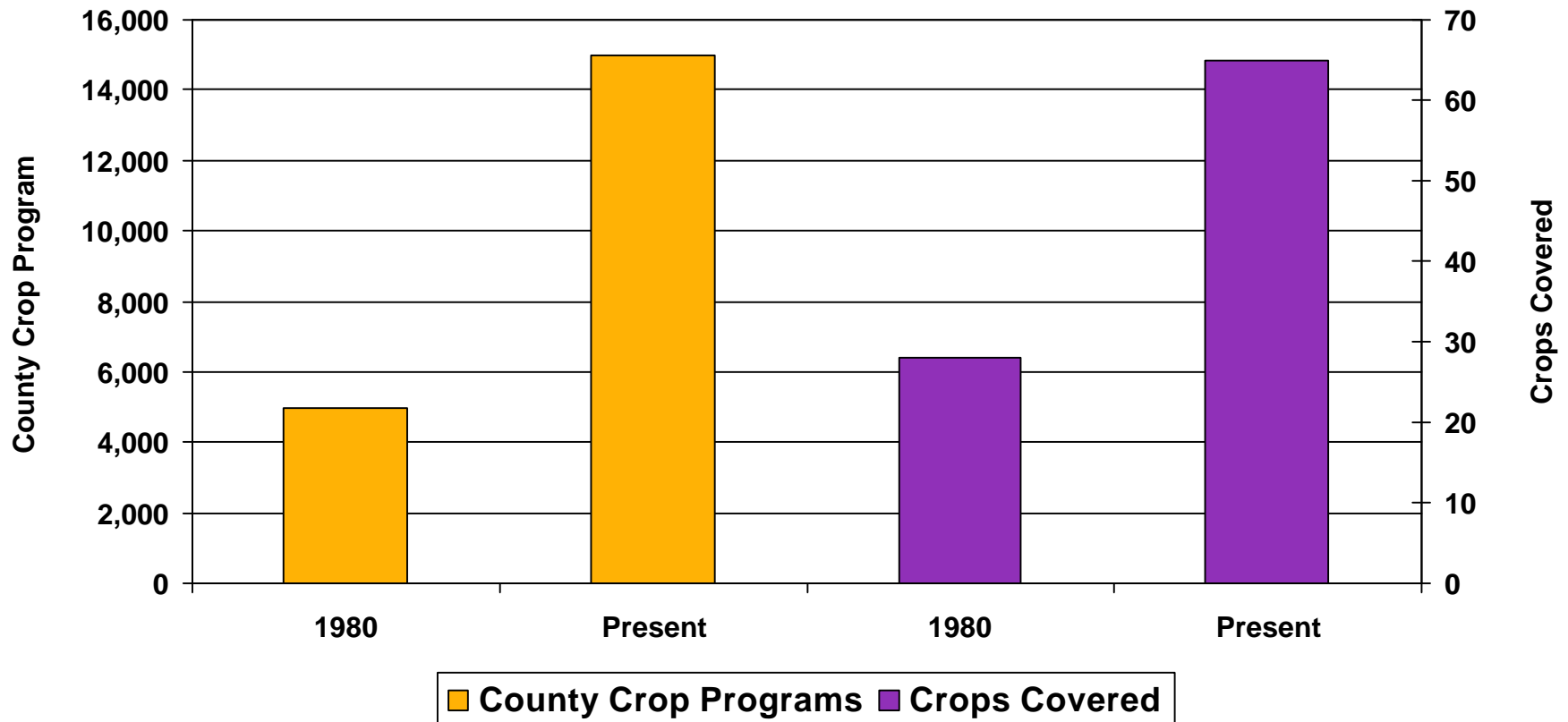
- With the help of the private sector, the participation rate increased from a low of 10 percent in 1980 to 70 percent today — well above the level called for in 1980 by Congress (pp. 17-19).



The scope of the program has expanded dramatically

- In the years following the passage of the 1980 Act, the number of county crop programs (i.e., insurance contracts for a particular crop in a particular county) grew from under 5,000 to more than 15,000 (p. 16).
- Although much remains to be done to increase the number of crops for which insurance is available, the number had increased from 25 in 1980 to 65 in 1998 (p. 17).

The scope of the program has expanded dramatically (pp. 16-17)



Administrative costs have been contained

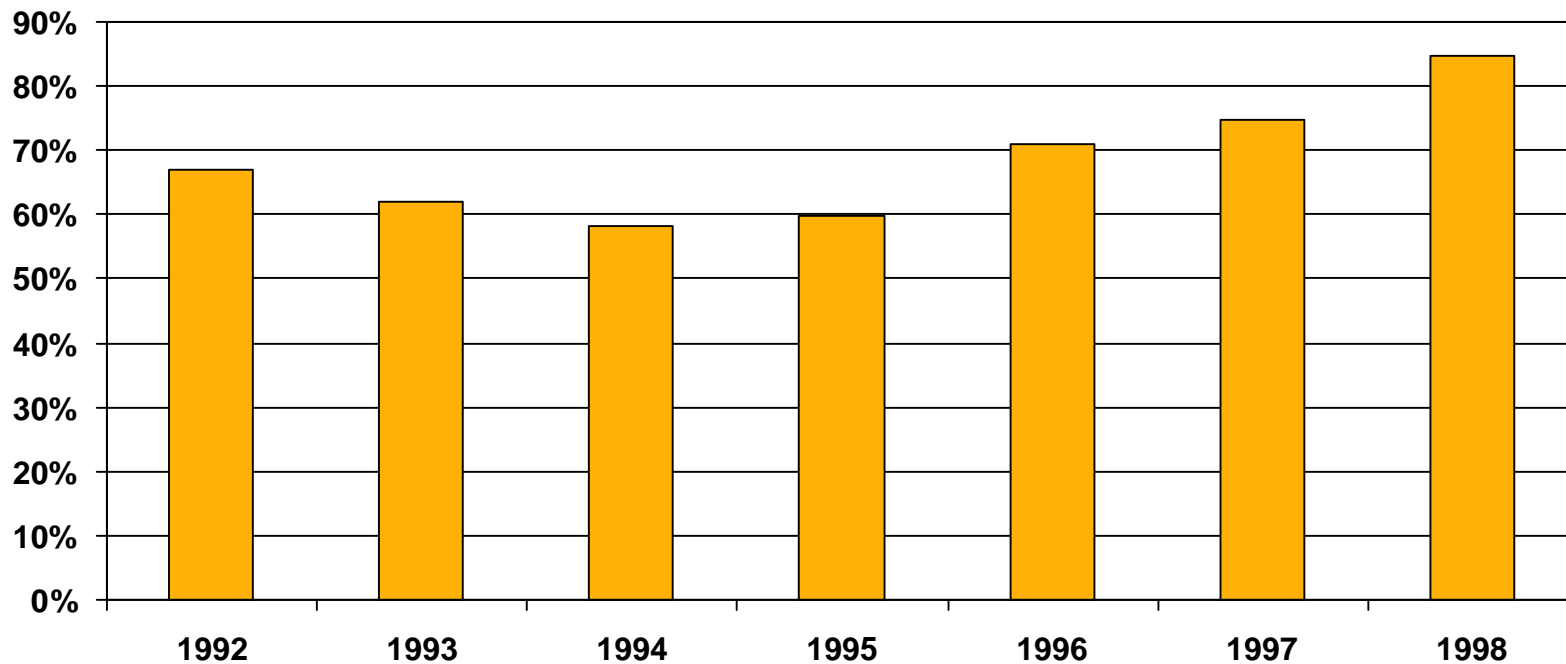
- **The private sector's success in expanding the crop insurance program has been achieved at a surprisingly modest cost (p. 19).**
- **On an inflation-adjusted per-insured-acre basis, both reinsured company administrative costs and total program administrative costs have declined since the mid-1980s (p. 19).**

The private sector has assumed an increasing degree of risk

- By 1992 the share of risk premiums retained by the private sector had risen to 67 percent (p. 20).
- In subsequent years this percentage fell slightly, but rose sharply with the 1996 reforms (p. 20).
- In 1997 it rose further, reaching 75 percent (p. 20).
- The 1998 Standard Reinsurance Agreement (SRA) goes even further in assigning risk to the private sector (pp. 20, 22-26).

The private sector has assumed an increasing degree of risk (pp. 20-26)

Share of Risk Premiums Retained by Private Sector



**The OIG Report Reflects Flawed
Methodology and Reasoning and
Presents Conclusions and
Recommendations that Cannot Be Relied
Upon**

OIG misstates the degree of risk assumed by the private sector

- **A key conclusion of the OIG report — that the private companies that participate in the program are insufficiently at risk for losses — is false (pp. 21-26).**
- **All of the conclusions that the OIG report draws from this faulty premise are unreliable (p. 22).**
- **The OIG report presents no independent basis for its conclusions other than its faulty premise (pp. 22-26).**

OIG's analysis focuses on a short and atypical time period

- **The report asserts that private companies are making too much money from their participation in the program and focuses on underwriting gains earned over the past four years (pp. 26-27).**
- **However, this period represents the most favorable consecutive four years of loss experience in the program's sixty year history (pp. 27-29).**
- **The only way to evaluate the financial integrity of the program is to evaluate it over the full loss cycle, which the report does not do (p. 27).**

OIG's audit approach cannot support the sweeping charges made in the report

- **OIG audits are typically based upon judgmental and/or biased samples that cannot support conclusions regarding the frequency or severity of the cited problems (pp. 29-31).**
 - ▲ **Doing so is akin to a doctor concluding based on his experience that everyone is sick, or a policeman concluding that everyone is a criminal.**

- **Many audits are based upon samples too small to provide confidence in the report's conclusions (p. 31).**

- **Instances in which actions have been “questioned” by OIG are treated as though they represent confirmed problems (pp. 31-32).**
 - ▲ **Information on how these questions have been resolved is never presented.**

OIG's report raises new issues and criticisms not supported by prior investigations

- **OIG errs both in misrepresenting its prior work and in drawing major policy conclusions based on insufficient or nonexistent evidence (pp. 32-33).**
- **No prior audit cited by the OIG supports its claim that “Company Revenue Increased At the Expense of Good Program Management” (pp. 32-33).**
- **The report identifies as the root cause of the alleged problems that the reinsured companies do not share sufficiently in the risk of crop losses. The companies in fact bear substantial risk (p. 33).**

OIG's report raises new issues and criticisms not supported by prior investigations (cont'd.)

- **The report claims that there is “pressure on loss adjusters to rubber-stamp policyholders’ loss claims” (p. 33).**
 - ▲ **Audits cited to support this claim, however, simply document adjuster errors.**
 - ▲ **OIG provides no evidence of pressure on the part of the reinsured companies to “rubber-stamp” claims.**
- **Prior FSA work contradicts this assertion, stating that “overall loss adjustment performance is acceptable” (p. 33).**

OIG's report raises new issues and criticisms not supported by prior investigations (cont'd.)

- **The OIG report draws broad conclusions from limited experience with a small number of very specialized products (p. 34).**
 - ▲ **It cites an audit of crop insurance on fresh market tomatoes, raisin losses, and the nursery crop insurance program.**
 - ▲ **Little attention is paid to crops such as wheat, corn, or soybeans that are of huge economic significance both to the agricultural economy and to the crop insurance program.**
 - ▲ **The single instance that did examine a major crop focused on a limited geographic area not climatically suited to its production.**

Turning Crop Insurance Delivery Over to the FSA Would Irreparably Harm the Program

Major reductions in sales effort will occur

- **Historically, FSA's clientele has come into FSA's offices to enroll in programs offering some future financial benefits (p. 35).**
 - ▲ **Selling crop insurance, however, is currently the task of professional, trained insurance agents who generally operate in the field with producers of food and fiber (p. 42).**
 - ▲ **The organizational structure and limited resources of FSA will not allow FSA to take the sale of the product to producers (pp. 43-44).**

Program integrity will suffer

- **FSA's record in adhering to specific programmatic requirements and standards does not inspire confidence in its ability to protect the integrity of the crop insurance program (pp. 38-41).**
- **This laxity appears to be especially apparent when conflicts have arisen between adherence to program requirements and delivery of funds to producers (pp. 40-41).**
- **Past behavior suggests a tendency to bend the rules in order to get money out the door (p. 44).**
- **Under public delivery one could anticipate similar biases and similar behavior on the part of FSA (p. 44).**

Re-equipping FSA for public delivery would require major expenditures

- The current FSA has little experience with crop insurance delivery, and it lacks the personnel, organizational structure, and information systems needed to carry out this function (pp. 46-47).
- The one-time costs associated with creating within FSA even a rudimentary delivery system would be substantial (pp. 46-56).
 - ▲ Costs of hiring new staff, estimated at **\$44 million** (pp. 47-50).
 - ▲ Costs of developing the information systems needed to support delivery of crop insurance, estimated at approximately **\$200 million** (pp. 50-51).
 - ▲ Costs of maintaining private delivery capability during the transition period, estimated at over **\$265 million** (pp. 52-54).

Public delivery is more expensive on an ongoing basis

- Evidence indicates that public delivery is more expensive than private delivery per policy, and substantially more expensive per dollar of coverage sold (pp. 55-56).

**Maintenance of the Current Public/Private
Partnership Is the Only Feasible Way to
Achieve Program Goals**

The current public/private partnership is the only feasible way to achieve program goals

- **A purely private multiple peril crop insurance program designed and delivered by private insurance companies without government assistance or control would not meet the objectives of the program (pp. 59-62).**
 - **Without public support, rates would be higher than those offered by the present system (pp. 59-60).**
 - **Without the current universal service requirement, farmers with unfavorable loss histories would be denied coverage (pp. 60-61).**
 - **The program would likely be more limited in terms both of the geographic areas in which it would be available and the crops and perils it covered (pp. 61-62).**
 - **As a result of all of these factors, participation rates would be significantly lower than at present (p. 61).**
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A purely public delivery system would be no more capable of meeting program objectives

- **Opportunities for political intervention in program operation would multiply (p. 63).**
- **Relaxation of compliance mechanisms would degrade program integrity (p. 64).**
- **Loss of actuarial soundness is likely (pp. 64-65).**
- **Intensity of the sales effort and accessibility of farmers to the program would decline (pp. 62-63).**
- **Substantial reductions in participation are likely, with resulting reductions in availability of commercial farm credit (p. 63).**
- **Reduced participation would encourage a return to the former ad hoc system of providing disaster assistance (pp. 64-65).**

Conclusion

It is clear that neither the private sector nor the public sector is capable by itself of achieving important goals set by Congress for the crop insurance program. A genuine partnership between the private sector and the Risk Management Agency is essential.