PolicyPennings by Daryll E. Ray & Harwood D. Schaffer

Crop insurance is under fire from two fronts: budget cutters and critics of its adequacy as a safety net

Crop insurance has been in the news quite a bit in the last couple of weeks and little of it is supportive of the program, on the one hand, or good news for farmers who are facing well below-the cost-of-production harvest-time prices, on the other.

Let's start with the item that has the most immediate impact on farmers—low harvest-time prices. According to calculations made by Gary Schnitkey at the University of Illinois, with a harvest-time price of $3.83 per bushel on a $4.15 projected price, corn yields will need to be at least 8 percent below the production history specified in the policy for revenue insurance to make a payment—and that is at the 85 percent coverage level (http://tinyurl.com/oqngh5a). For coverage levels below 85 percent, the yield has to be even lower than that, dropping to 54 percent of production history before a payment is made on 50 percent coverage policies.

The story is no better for soybeans. With an $8.91 per bushel harvest price on a $9.74 2015 projected price, soybean yields would have to be at least 7 percent below the production history specified in the policy for farmers to receive an insurance payment. The problem with the situation that farmers find themselves in this year is that low prices generally indicate they will find themselves with average or higher than average yields.

Higher soybean yields overall suggest that the farmers with yields 7 percent below their historic average will be relatively few in number. Farmers who bought 50 percent coverage on their revenue policies will need yields below 55 percent of their production history figure to collect an insurance payment; no one wants to be in that situation. Individually, when prices are low, farmers seek high yields—not low yields—to maintain per acre revenue.

While the recent budget agreement between Congress and the White House prevented a default on the national debt and reduced chances of an immediate government shutdown, it came at a price. Part of that price was a cut to the overall rate of return for crop insurers from 14.5 percent to 8.9 percent (http://tinyurl.com/qhsgtnu). This raises the concern of farmers who fear that with a lower overall rate of return, some crop insurers will drop out of the market, making crop insurance harder to obtain.

In responding to the reimbursement cuts, National Farmers Union President Roger Johnson said, "More and more crop insurance providers are exiting the sector because these cuts have made it no longer profitable to be engaged in this business. Since 2013 we have witnessed the exit of five large crop insurance providers with additional providers teetering on the edge. NFU remains concerned about concentration in the marketplace and its impact on farmers and ranchers. These budget cuts would accelerate the consolidation of the crop insurance sector" (http://tinyurl.com/ng9ltad).

In response to the immediate backlash from the agricultural sector, members of the House and Senate agricultural committees have indicated that they will seek to restore those cuts in the spending bill that Congress will have to approve by the December recess to guarantee that there will be no government shutdown, though other spending issues will certainly be thornier than the change in the rate of return to crop insurers.

Before the final vote had been made on the budget/debt limit deal, Representatives Sensenbrenner and Kind, both of Wisconsin, introduced bi-partisan legislation to cut $24 billion from crop insurance over the next ten years.

According to a summary of the bill provided by Agri-Pulse the legislation titled "Assisting Family Farmers through Insurance Reform Measures" (AFFIRM) would "limit federal crop insurance subsidies to $40,000 per farmer per year" (http://tinyurl.com/ntz98jf). At present the largest farmers get the largest subsidies because they farm more acres that are covered by crop insurance. It is estimated that "the bottom 80 percent of policyholders received only 27 percent of subsidies in 2011, with an average subsidy of around $5,000."

At present, the administrative and overhead (A&O) costs for the crop insurance program are split by the government and the companies, providing the companies with about $1.3 billion a year. AFFIRM would limit the government A&O payments to $900 million a year.

According to the Agri-Pulse summary, "the bill ends the provision that prohibits the USDA from negotiating a better deal for taxpayers in Standard Reinsurance Agreement (SRA). When the SRA was renegotiated in 2010, over $6 billion in taxpayer savings was found. Unfortunately, the 2014 farm bill prohibits the USDA from finding any additional savings that could reduce the deficit. In fact, any savings are currently required to be put back into the crop insurance program."

Another provision would include a reduction in the guaranteed rate of return from 14.5 percent to 8.9 percent that was included in the budget/debt ceiling legislation discussed above.

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The proposed legislation would also eliminate the government subsidy for the Harvest Price Option (HPO) that allows farmers to use the higher of the price guarantee that was set at the time the insurance policy was purchased and the harvest price. When prices increase during the growing season, this option increases the revenue guarantee. HPO policies could still be offered but farmers would have to cover the full cost.

"Finally, the bill introduces transparency into the crop insurance program by requiring the reporting of all producers/entities that receive federally subsidized crop insurance. Also, it requires the reporting of the underwriting gains, A&O reimbursements and indemnities and reinsurance of the crop insurance providers."

While various farm groups may support one or more provision of AFFIRM, by putting them together in one bill, Sensenbrenner and Kind have almost guaranteed that most of the major farm organizations will join together in opposing it in its present form—and some in any form.

But that doesn't necessarily protect crop insurance from efforts inside and outside of agriculture to reform it. The biggest problem with crop insurance is the one that we discussed at the beginning of this article. While crop insurance is touted as a risk management program, it fails to protect farmers against the most serious risk of all—major multi-year drops in price.

If the current low prices continue into the third and fourth years of the 2014 Farm Bill, there will be significant pressure from agriculture to find ways to provide risk management tools other than crop insurance. The Average Revenue Coverage (ARC) and Price Loss Coverage (PLC) were supposed to provide for price risk, but most farmers chose ARC and if prices are stable at a low level, it, too, is an inadequate risk management tool.

Unless there is a sudden increase in demand or a significant crop failure somewhere in the world, the next two years may begin to look like 1998.

Harwood D. Schaffer is a Research Assistant Professor in the Agricultural Policy Analysis Center, Institute of Agriculture, University of Tennessee.

Daryll E. Ray is Emeritus Professor, Institute of Agriculture, University of Tennessee, and is the former Director of the Agricultural Policy Analysis Center (APAC). (865) 974-3666; Fax: (865) 974-7484
; hdschaffer@utk.edu and dray@utk.edu; http://www.