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Proposed Crop Insurance Cuts

A few weeks ago, the Trump Administration released its 10-year proposed federal budget proposal, which is targeted to reduce federal expenditures on crop insurance by $58.7 billion over the next ten years, or approximately a reduction of $6 billion per year for the next decade. Many similar cuts have also been proposed as measures to reduce the federal budget deficit by some members of Congress in recent years. In the past, there has been enough bipartisan support from members of Congress representing areas with significant agriculture production to prevent the passage of legislation with drastic cutbacks to the Federal Crop Insurance Program.

The current Administration budget would achieve the crop insurance reductions by limiting the maximum federal premium subsidy to $40,000 per farm operation. Currently, there is no limit on the maximum premium subsidy. The Administration proposal would also eliminate the popular Harvest Price Option (HPO) for crop insurance that is utilized as a risk management tool by most Midwest corn and soybean producers. In addition, the Administration revisions would eliminate federal crop insurance coverage to any farm operation that exceeds $500,000 in adjusted gross income (AGI). If all of these changes were implemented, it could drastically change the federal crop insurance program for many crop producers, as we know it today.

The average federal subsidy for most common levels of crop insurance coverage for corn, soybean,s and wheat is about 60 percent. In other words, if the gross cost of the crop insurance premium is $40 per acre, the farmer would pay $16 per acre (40%) and the federal subsidy would $24 per acre (60%). Under the Administration proposal, once a farm operator hits the $40,000 limit, the farmer would be required to pay 100 percent of the crop insurance premium, which would be a significant increase in the cost of insurance coverage.

The Crop Insurance Title of the Farm Bill provides crop insurance availability for over 100 different crops, including many high value fruit and vegetable crops. There is a wide variation in the level of

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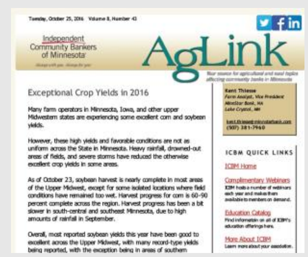

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crop acres required to hit the proposed $40,000 premium subsidy limit. Producers with very high value crops could hit the subsidy limit with just a few hundred acres, while producers in some other areas may require 6,000 or more acres to reach the limit.

Corn and soybean producers in many upper Midwestern states that typically utilize 80 percent revenue protection (RP) crop insurance coverage with HPO would likely hit the $40,000 limit at approximately 1,500 to 2,000 acres, which is not a large farm operation by today's standards. Farm operators who raise some acres of canning crops or specialty crops with higher crop insurance premiums may hit the insurance subsidy limit with even fewer acres. Producers that utilize higher coverage levels of crop insurance coverage (such as 85% RP) or other special crop insurance options that may be subsidized could also reach the subsidy limit with fewer acres.

In the late 1990s and early 2000s, the Federal government offered increased premium subsidies and developed new products in order to encourage greater participation in the Federal Crop Insurance program. The Federal government wanted to eliminate the need for ad-hoc disaster programs that were enacted on an annual basis several times prior to that time period, as a result of natural disasters in varying crop producing areas of the U.S. There have been very limited ad-hoc Federal disaster programs related to crop production in recent years, even though we have experienced some major natural disasters, such as the 2012 drought, in widespread crop producing areas of the U.S.

Most corn and soybean producers in Minnesota and other Midwestern states purchase Revenue Protection (RP) crop insurance policies, which protect against the combination of yield losses and price reductions during the growing season. A base revenue level is established on a farm unit using the historic average crop yield times the national average crop price on March 1, at the beginning of the insurance coverage period. With RP policies, the insurance coverage level purchased by farm operators is a percentage of that base revenue, ranging from 50 percent up to 85 percent. Insurance coverage levels of 75 percent to 85 percent are the most common for Midwest corn and soybean producers in recent years. The final crop revenue on the insured farm unit is the actual crop yield times the crop price at harvest time. If the actual crop revenue is lower than the guaranteed insurance coverage, a crop insurance indemnity payment is made for that crop on that farm unit.

Most producers also utilize the Harvest-Price Option (HPO) that is available with RP insurance policies. The HPO permits producers that incur yield reductions greater than their coverage level (ex. - 80% of average yield) to have added crop insurance protection if crop prices are higher at harvest time than the base price on

March 1. This option allows farm operators to forward price a higher percentage of their crop production at profitable prices, while still having insurance protection against the possibility of very low crop yields at harvest time. Without the HPO option, using hedging or other forward pricing tools prior to harvest becomes much riskier. This could lead to some agricultural lenders being unwilling to extend credit to finance grain hedging positions for some farm operators.

What is often overlooked with the HPO insurance option is that it only comes into play when the crop insurance harvest price is higher than the March 1 base price for a given crop. At that point, the RP insurance policy functions the same as a Yield Protection (YP) insurance policy, which pays insurance indemnity payments on yield losses only. As a result, the only producers able to collect crop insurance indemnity payments for a given crop in those years are those with a yield reduction due to a natural disaster.

For example, a corn producer with an APH yield of 180 bushels per acre, with an 80 percent RP policy in place, would need an actual corn yield below 144 bushels per acre to collect an indemnity payment for the year. So, the HPO option does not a provide a windfall profit for producers with higher yield levels, as some critics have portrayed.

The Federal Crop Insurance program is the main risk management program that is utilized by crop farmers across the U.S., including Minnesota and the surrounding states. If Congress were to enact legislation that included the Administration crop insurance proposals, it would certainly impact most crop producers in the Midwest and other areas.

In recent years, there have been other proposals to reduce or restrict crop insurance benefits. However, these proposals have never gotten too far in Congress. There now seems to be a bit more momentum behind the current proposals to change crop insurance, with support from the Trump Administration, as well as from some budget conservatives in Congress. At the same time, other members of Congress and agricultural leaders are stressing the need to maintain a strong crop insurance program as the centerpiece of a risk protection program for U.S. crop producers, especially during these times of reduced farm profitability.

For more information, contact Kent Thiesse, Farm Management Analyst and Vice President, MinnStar Bank, Lake Crystal, at: 507-381-7960 or kent.thiesse@minnstarbank.com.

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