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Alternatives for the Crop Insurance Harvest Price Option

BACKGROUND

The Harvest Price Option (HPO) crop insurance policy provides protection on lost production at the higher of the price projected just before planting time or the price at harvest. Since projected price is an estimate of the final price, farmers are often willing to pay a higher premium for the additional harvest price protection.

If there is a natural disaster that results in a large drop in production of a commodity, the price of that commodity is likely to increase sharply. Without the HPO, the farmer's loss would be indemnified at the lower price projected at the start of the season. Unfortunately, such an indemnity would place many farmers in financial jeopardy. Many farmers enter a forward contract to sell a portion of their production before harvest. Usually these contracts pay the farmer for the production they deliver after harvest based on harvest prices. If the farmer loses the crop, they are still obligated to deliver under the forward contract. But since the crop is lost, the farmer would have to buy the commodity at the harvest price and deliver that or financially settle the buyer's contract at the harvest price. The purpose of the HPO is to provide the farmer with sufficient funds to settle the forward contract.

Another example of the application of the HPO is for farmers who raise dairy cows, cattle, hogs, poultry, or other animals and grow their own feed. If a disaster wipes out their feed production, the farmer has to enter the market and purchase feed at the going price, which would reflect the effects of the disaster. The HPO provides them with the funds to afford the higher feed costs should feed prices rise.

Under HPO, the farmer selects the amount of average yield he or she wishes to insure from 50 to 75 percent. In some areas of the country, up to 85 percent insured yield is available. In 2015, more than 70 percent of the crop policies purchased by farmers were HPO policies.

A farmer may also select a revenue policy with the harvest price exclusion. These policies insure in the same manner as HPO policies, except the amount of insurance protection is based on the projected price, only so the amount of insurance protection is not increased if the harvest price is greater than the projected price. In 2015, only three percent of the crop policies purchased by farmers were Revenue Protection policies with the harvest price exclusion.

ISSUE

On several occasions over the last three years, members of Congress have proposed legislation to eliminate the subsidy for the HPO within the federal crop insurance program. In 2014, the Congressional Budget Office estimated that such legislation would save the federal government $19 billion over 10 years. The President proposed a similar measure as part of his FY2016 budget submission.

At this point, no proposals have suggested elimination of the HPO and thus would not impact the premium subsidy on the underlying policy provided to farmers by the federal government. Proposals have focused only on elimination of the subsidy for adding on HPO. Farmers would be able to add-on the HPO coverage, but would have to pay the full premium.

The HPO revenue insurance policy is very similar to Replacement Cost Coverage in property insurance. If you consider the value of your TV, vacuum cleaner, furniture, or any other item in your home, it would almost certainly cost you more to replace that item than what you paid for it originally. Replacement Cost Value is the amount it would cost to repair or replace an item with one of the same kind and quality as the original in today's market.

Let's look at an example. You own a five-year-old TV, and you paid $550 for it. The expected lifespan of a TV is ten years. Each year, the value of the TV decreases by some amount – let's say $50. Because the TV is five years old, its value has depreciated $250 and its actual cash value is now $300. In this example, if the TV is stolen and your home insurance policy provides Actual Cash Value coverage, you would be reimbursed $300. If you had Replacement Cost coverage for your TV, you would normally be reimbursed for the full cost of replacing it rather than only the value when it was stolen. In other words, your insurance policy would pay what it would cost to go out to a store and purchase the item today.

You pay more for replacement cost coverage than actual cash value coverage – just as farmers pay significantly more for the HPO coverage than for the exact policy that covers only the projected price at planting.

OPTION #1

Keep current HPO premium discount.

OPTION #2

Reduce the HPO premium using a net farm income sliding scale or other forms of means testing.

OPTION #3

Cap or eliminate the HPO premium subsidy.