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The new common crop insurance policy

by William Edwards, extension economist, 515-294-6161, wedwards@iastate.edu

For several years the Risk Management Agency (RMA) of the United States Department of Agriculture (USDA) and the various private insurance companies that deliver crop insurance protection to millions of producers across the country have been negotiating a major overhaul of the basic policy that is used for most insurable crops. The new Common Crop Insurance Policy, sometimes known as COMBO, will go into effect for crops insured in 2011. Covered crops include corn, soybeans, grain sorghum, wheat, barley, cotton, rice, canola and sunflowers.

Insurance plans

Over the past 20 years several new types of crop insurance policies have been introduced. Major changes included insuring gross revenue instead of bushels, combining insurance units and basing guarantees on county yields instead of individual farm yields. Eventually the number of choices became longer and longer, and more confusing. The new policy simplifies and streamlines the choices.

Individual plans

Instead of a different policy for each type of insurance, there will now be one master policy with several options:

- Yield Protection
- Revenue Protection
- Revenue Protection with Harvest Price Exclusion

Yield Protection (YP) is equivalent to the old Actual Production History (APH) policy. Yield protection establishes a guarantee based on the APH yield, which is determined by four to ten years of actual yield records. No changes were made in how APH yields are calculated for each insurance unit. Producers can choose to guarantee from 50 to 85 percent of their current APH yield. A major change from the old APH policy is that the indemnity price used to calculate the payment made to the producer in the event of a loss is now the same as the price used for revenue insurance policies. Previously RMA set the indemnity price using forecasts for fall cash prices.

For spring planted crops the average closing futures price for each working day during the month of February is used. The corn price is based on the December CME contract, while the November contract is used for soybeans. Producers can choose to use from 55 to 100 percent of this price for the indemnity price at which yield losses are

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Handbook updates

For those of you subscribing to the handbook, the following updates are included.

Crop Planning Prices – A1-10
(1 page)

Suggested Closing Inventory Prices – C1-40 (2 pages)

Please add these files to your handbook and remove the out-of-date material.

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paid. Naturally, choosing a higher price will result in a higher premium. Catastrophic level yield coverage (CAT) is still available for a cost of \$300 per crop. The guarantee is 50 percent of the APH yield, and losses are paid at 55 percent of the indemnity price.

Revenue protection

A producer can also choose Revenue Protection (RP), which is equivalent to the old Crop Revenue Protection (CRC) and Revenue Assurance with the harvest price option (RA-HPO). Revenue Protection guarantees the insured producer a minimum number of dollars of gross revenue per acre. The yield used to set the guarantee is the same as the APH yield used for Yield Protection, and the price is the same February futures price. The guarantee is the product of these two values, times the level of guarantee selected (from 65 to 85 percent). There is no option to select less than 100 percent of the February price for the guarantee, and catastrophic coverage is not available.

If the average CBOT price for the relevant contracts during the month of October is higher than the February price, the guarantee is increased, based on the October price. The October price is also used to calculate the "actual" revenue. This is exactly the same procedure that was used previously for CRC policies. RA policies used the average November price for corn, but the new Revenue Protection option will use the October price for both crops. Approximately 85 percent of the insured corn and soybean acres in Iowa in 2010 were covered with this type of policy.

Harvest price exclusion

The third option is called Revenue Protection with Harvest Price Exclusion (RPE). It is equivalent to the former basic Revenue Assurance (RA) policy. The only change is that the harvest price for corn will be the average for October instead of November. Under this option the guarantee does not increase even if the October price is higher than the February price. Consequently, premiums will be lower for RPE than RP.

Table 1 summarizes the old and new terminology. Current policies will automatically be converted to the corresponding policy option for 2011 unless the producer requests a change.

Previously CRC and RA used different procedures for computing premiums each year. In some years RA-HPO was cheaper than CRC, and in other years CRC was cheaper, despite the fact that they offered essentially the same coverage. Under the new Common

Crop Insurance Policy only one set of premiums will be offered. The level of premium subsidies provided by RMA will not change.

Group plans

Three insurance options based on county yields instead of individual farm yields are still available:

- Group Risk Plan (GRP)
- Group Revenue Insurance Plan (GRIP)
- Group Revenue Insurance Plan with harvest price option (GRIP-HPO)

There were no changes made to the group insurance plans. Group risk policies have not been widely used in Iowa, typically accounting for only about four percent of the total insured acres in the state.

Enterprise and whole farm units

Two years ago RMA increased the level of premium subsidies for policies specifying enterprise and whole farm units, to match more closely the percent subsidies for basic unit coverage. Many producers elected to shift to enterprise units, and bought a higher level of guarantee for essentially the same cost as for a lower guarantee under basic units.

This will be continued under the new common policy. Enterprise and whole farm units offer producers a substantial savings in premiums compared to basic or optional units. Previously CRC based the discounts on the number of acres insured, while RA used the number of township sections included in the policy. The new common policy requires that the acres covered must be located in at least two sections within a county to qualify for enterprise unit designation. In addition, the crop acres in each section must be larger than the lesser of 20 acres or 20 percent of the total acres. Thus, one large unit combined with one very small unit may not qualify.

Whole farm units are also available for Revenue Protection (but not Yield Protection), in which all insurable crops in a county are combined into one coverage unit. The revenue guarantee and the actual revenue are aggregated over all the insured crops. The policy must include at least two crops that each make up 10 percent or more of the total planted acres. Eighty percent of the premium for whole farm unit policies is paid by RMA.

Combining more acres and farm units into a single policy reduces the probability of collecting at least a small payment each year. The more spread out the individual

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units are, the more this is true. However, when an indemnity payment is triggered, it will likely be a larger payment. Moreover, the biggest risk in recent years has come on the price side of the equation rather than the yield side, and price declines have the same effect on enterprise and whole farm coverage as they do on basic or optional units. Nevertheless, farmers who opt for enterprise or whole farm coverage may want to consider purchasing add-on coverage to take care of localized weather events such as hail.

Table 1. Old and new crop insurance policy options

Old policy option	New policy option
Actual Production History (APH)	Yield Protection (YP)
Crop Revenue Coverage (CRC) Revenue Assurance with Harvest Price Option (RA-HPO)	Revenue Protection (RP)
Revenue Assurance (RA) Income Protection (IP)	Revenue Protection with Harvest Price Exclusion (RPE)



The 2011 costs of crop production

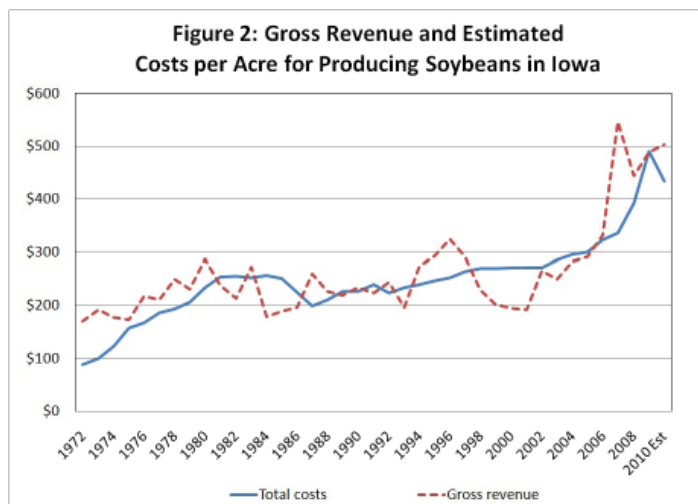
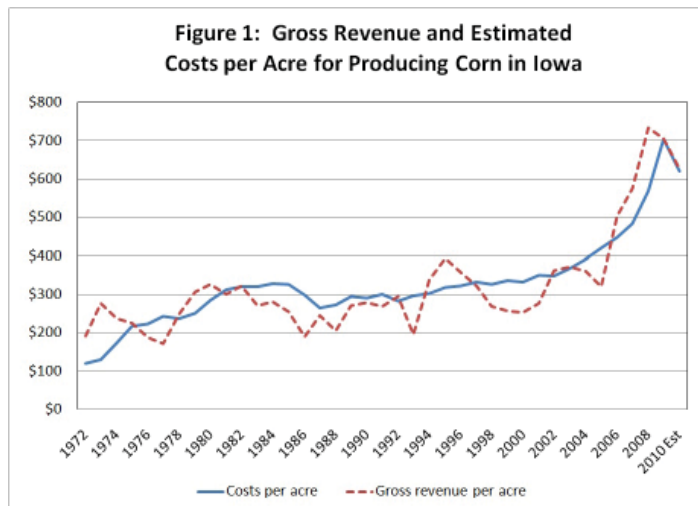
by Mike Duffy, extension economist, 515-294-6160, mduffy@iastate.edu

One of my jobs at Iowa State University is to produce the estimated costs of crop production. Over the years I have had the opportunity to work with some wonderful students and received information from many people around the state. In spite of all this help, sometimes I feel like I need to use a Ouija board because things are changing so fast.

We are currently in one of those times. I did a preliminary cost estimate in July. Since then the estimated costs have increased \$.34 a bushel for average yield corn following corn. For corn following soybeans, the cost estimated has increased \$.22 per bushel for the average yield.

This article will discuss some of what I have seen with respect to cost of production estimates. In preparing the estimates, I divided the costs of producing crops into four broad categories; machinery costs, costs for land, labor and general input costs. It could be debated whether this is the best way to think of production costs, but that is another discussion. Within these categories, I will cover where we have seen the most change over the years.

One of the first things you notice when examining the costs of production is that they are very closely correlated with the gross revenue for the crop. This is true for both corn (Figure 1) and soybeans (Figure 2). The relationship between gross revenue and costs



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of production is stronger for corn, but there is still a very strong relation between the gross revenue from soybeans and the cost to produce them.

Gross revenue changes in a more erratic manner than the costs of production. But, there are very definite patterns which produces a high degree of correlation between the costs and revenues. Notice in Figures 1 and 2 how the revenues and costs were increasing at a fairly steady rate during the 1970s. Then they were flat to declining slightly in the 1980s and early 1990s. The past few years have seen an explosion in both costs and returns. From 2002 to the peak in 2008, gross revenue for corn increased 103 percent. From 2002 to the peak in 2009, costs of production for corn increased 102 percent. Since that time both costs and revenues have fallen back, but we are in a situation where they are both rising again.

Part of the reason for the strong relationship between gross revenue and costs of production is the relation between gross revenue and land values. Land values have a strong correlation with costs of production. Between 1972 and 2010 land represented an average of 34 percent of the costs of producing corn and 45 percent the costs of producing soybeans in Iowa.

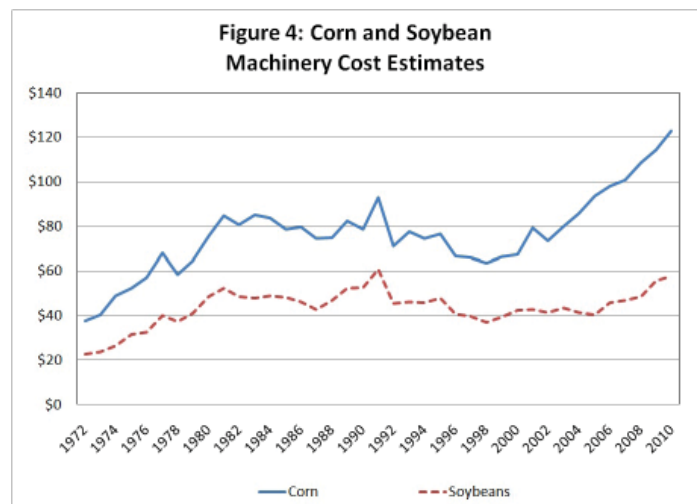
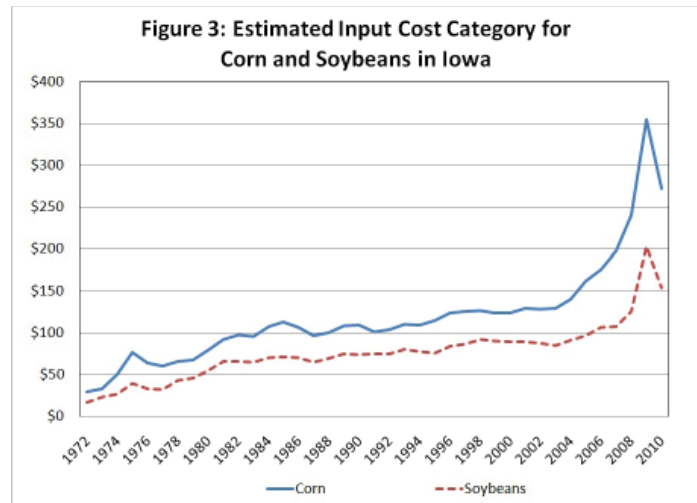
The percentage of total costs attributed to the land has varied by over 10 percent. During the late 1970s when land values were at record highs remains the period when land as a percent of total costs of production was at historical levels.

Input cost changes

The general input cost category includes seed, fertilizer, pesticides, insurance, interest and other such items. Overall since 1972, inputs have averaged 35 percent of the total cost of corn production ranging from 25 to 50 percent of the total costs. Soybeans have shown a similar pattern, although not as dramatic. Since 1972, inputs have averaged 30 percent of total costs ranging from 17 to 41 percent. Inputs as a percent of total costs have been increasing in the past few years. The individual cost components will be discussed in the next section.

Figure 3 shows the level of expenditure for inputs for both corn and soybeans. Notice that the recent rapid change shown in Figures 1 and 2 is again manifested in Figure 3. Corn input costs rose 111 percent from 2003 to 2010. Soybean input costs show an increase of 87 percent over the same time period.

Machinery costs have shown two major periods of increase. In the 1970s, machinery costs were increasing



at a fairly steady rate every year. Then the machinery costs remained relatively stable but in recent years costs have risen dramatically. Figure 4 shows the increases in machinery costs per acre. Machinery represents 24 percent of the total cost for producing corn and 18 percent of the total cost for producing soybeans.

Labor, as a percent of total cost, is almost exactly equal for corn and soybeans. Labor represents six percent of the total cost for corn and seven percent of the total cost for producing soybeans. Current technologies have substituted capital for labor and as a result labor is becoming less of a factor in terms of costs of production.

In general the figures show a period of rapid increase for both costs and revenues in the 1970s. This was followed by a period of relative stability and for the past seven or eight years we have again seen a rapid increase in both the revenue and the costs.

This observation is consistent with economic theory. In a competitive market when there is an increase in

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revenue (higher yields and/or higher prices) the costs of production will tend to follow. Land is the residual claimant after the increase in costs and the increase in the gross revenue. In other words, the input costs and other costs will increase when there is excess profit, what is left will be bid into the land in the form of higher rents or land values.

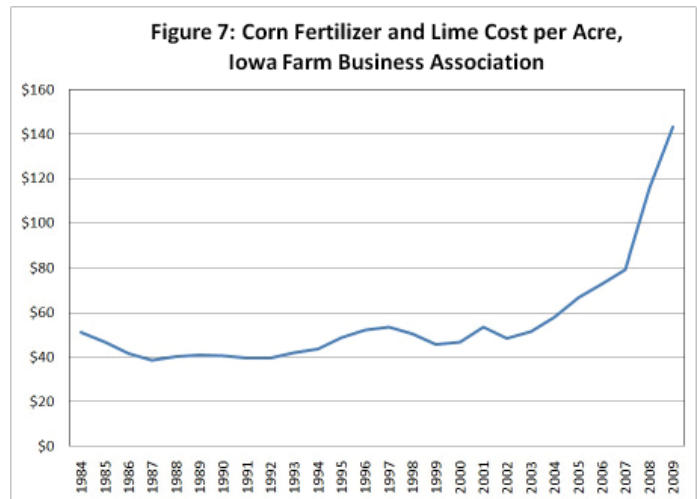
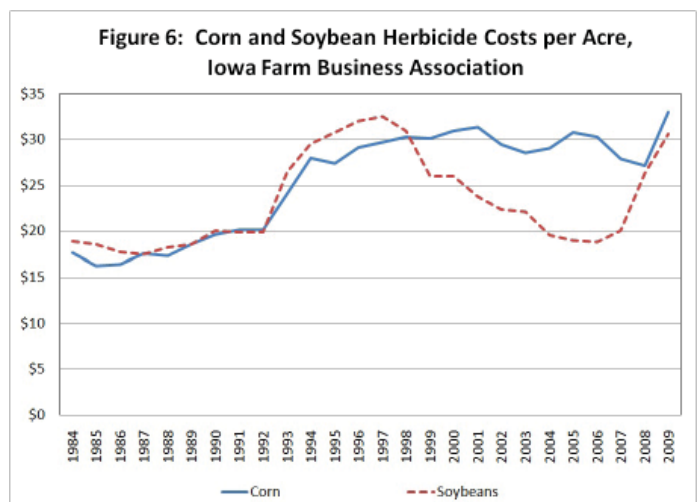
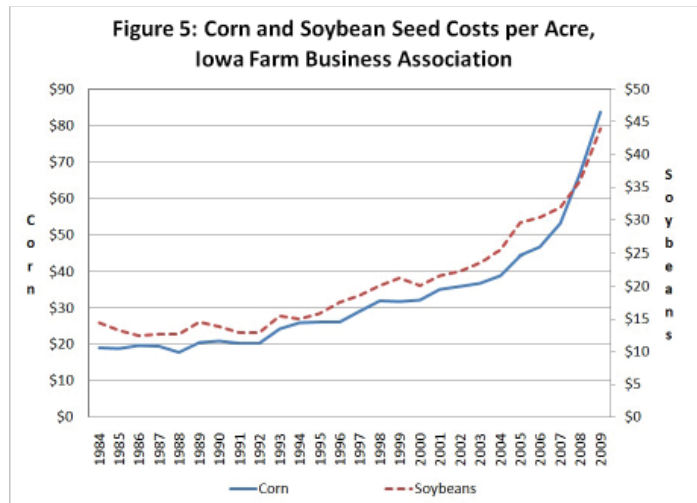
Specific input category changes

The cost of production data illustrate some of the major changes that have occurred in production agriculture over the past few years. One of the major changes has been in the use of genetically modified seeds. These seeds, both corn and soybeans, contain traits that have altered production practices and costs in a variety of ways. One of the major changes is using capital for a prophylactic treatment of pest problems. By having pest resistant traits contained in the seed the farmer pays more for the seed and foregoes the need to scout or estimate pest pressures.

The total impacts of this approach can be debated elsewhere but what is clear is the change in the cost structure that has occurred as a result. Figure 5 shows the cost per acre for both corn and soybeans since 1984. Notice that the costs begin increasing in the mid 1990s as the GMO seeds were being introduced. The costs in the past few years have increased substantially. Since 2005 the cost per acre for corn seed has increased 89 percent and the cost per acre for soybean seed has increased 49 percent.

One of the major traits in the seeds today is the resistance to certain herbicides. Figure 6 shows the change in herbicide costs for the farms in the Iowa Farm Business Association. There was a substantial rise in the 1990s but for corn the increase leveled out and for soybeans there was actually a substantial decrease in herbicide costs per acre in the mid-1990s. Both corn and soybean herbicide costs increased in the past year.

The other major category that has shown substantial changes over the past few decades is the fertilizer and lime costs for corn. Figure 7 shows the cost per acre for fertilizer and lime for farms in the Iowa Farm Business Association. The costs remained relatively flat until the early 2000s since then there has been a dramatic increase in costs. Since 2004 costs per acre are up almost one and a half times. Unfortunately, it appears quite likely that the costs for fertilizer will increase substantially in 2011.



Summary

The changes in costs of production reflect the changes that are occurring in Iowa agriculture today. Gross revenue has increased substantially, new seed technology has increased costs for seeds but has slowed the costs for herbicides and increased yields, and fertilizer

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costs reflect the cost of manufacturing and mining the material but more importantly they reflect the changing world conditions where the demand for the fertilizer nutrients has increased significantly.

These changes make it all the more important for farmers to be mindful of their costs. The rapid increases in prices can mask the tremendous increases that have been occurring in costs of production. Farmers must carefully evaluate the traits being offered in their seed and judge whether or not the added benefits of each

trait are worth the higher seed price. Fertilizer use should be based on need rather than a set practice. Trips across the field need to be carefully evaluated. The list of opportunities could go on but the point is that given the way agriculture is changing the costs to produce a bushel is just as important as the price per bushel or how many bushels you can produce. Being cost efficient isn't anything new but it takes on new importance in the world we live in today.

Updates, continued from page 1

Decision Tools and Current Profitability

The following tools have been added or updated on www.extension.iastate.edu/agdm.

Corn Profitability – A1-85

Soybean Profitability – A1-86

Season Average Price Calculator – A2-15

Returns for Farrow-to-Finish – B1-30

Returns for Weaned Pigs – B1-33

Returns for Steer Calves – B1-35

Returns for Yearling Steers – B1-35

Ethanol Profitability – D1-10

Biodiesel Profitability – D1-15

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