Crop Insurance for Tobacco: Issues and Updates

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GOALS TODAY
• Provide a basic overview of crop insurance for tobacco in North Carolina
• Give some updates on proposed amendments to tobacco crop insurance

Introduction
• Crop insurance is one of the most important tool for managing risk in U.S. agriculture
• USDA-RMA is the primary agency that oversees the U.S. crop insurance program
• Publicly supported-Privately delivered program
Introduction

• Why do we need crop insurance?
• Agricultural production is inherently risky
  – Adverse weather events
  – Pest infestations
• Not properly addressing production risks has financial consequences

Introduction

• Profit = (output price x output) –
  (input price x input)

• Negative risks affect ability to:
  – Pay bills
  – Meet farm business goals
  – Maintain lifestyle

Introduction

• Crop insurance is one strategy to manage production risk
  – Yield/Production shortfalls
• Not costless – weigh premium (cost) with the expected risk reduction (benefits)
  – Assess your own situation
Introduction

- Burley tobacco in NC – 59.6% of total acres insured (RMA, 2006)
  - Loss Ratio (I/P) = 1.44
- Flue-cured tobacco in NC – 93.3% of total acres insured (RMA, 2006)
  - Loss Ratio (I/P) = 3.83

Crop Insurance Options for Tobacco Growers

- Actual Production History (APH) Policy
  - Insures yield
  - For burley & flue-cured tobacco
- Adjusted Gross Revenue Lite (AGR-Lite)
  - Insures farm revenue
  - Any type of tobacco plus other crops/livestock (mainly for diversified operations)

Tobacco APH Policy

- Protects against yield shortfalls due to an insurable cause of loss:
  - Adverse weather (i.e. hail, drought, flood), fire, insects, plant disease, wildlife
- Coverage based on at least four years of actual yields (Approved APH yield)
  - FSA records prior to termination of tobacco program acceptable for calculating APH yield (i.e. classification yields for flue-cured)
Tobacco APH Policy

- Coverage levels:
  - 50% to 85% (in 5% increments)
  - Premium subsidies increasing from 67% for a
    50% coverage level to 38% for an 85% coverage
    level
- Price election – determines value
  - $1.52/lb (flue-cured); $1.62/lb (burley)
  - Can choose proportion of price

Tobacco APH Policy

- Catastrophic (CAT) coverage:
  - 50% coverage/55% price election
  - Fully subsidized (only $100 admin fee)
  - Any coverage above CAT is buy-up
- Sales Closing Date:
  - Flue-Cured: February 28
  - Burley: March 15

Tobacco APH Policy: Example

- Approved APH Yield Calculation
  - FSA classification yield prior to 2005
  - After 2005 has actual yield

  2003 Classification yield 2150 lbs/ac
  2004 Classification yield 2150
  2005 Actual yield 2000
  2006 Actual yield 2424
  \[
  \frac{8724 + 4}{4} = 2181
  \]
  APH yield
Tobacco APH Policy: Example

• APH Yield Guarantee:
  
  | Approved APH Yield | 2181 lbs/ac |
  | Coverage Level     | 70%         |
  | Yield Guarantee    | 1,527 lbs/ac |
  
  (2181 lbs/ac x 0.7)

• APH Indemnity Payment
  
  | Yield Guarantee | 1527 lbs/ac |
  | Price Election  | $1.52/lb    |
  | Actual Yield    | 527 lbs/ac  |
  | Indemnity       | $1520/ac**  |

  ** (1527 x $1.52) – (527 x $1.52) = $1520

  If producer premium $36, net indemnity is $1484/ac

Tobacco APH Policy: Unit Structure

• Insured unit(s) – designate the field(s)
  being insured
  – Separate coverage for each unit
  – Separate production records for each unit
  – Each unit planted to same crop
  – Cannot cut across county lines

• Unit options: Basic, Optional, Enterprise
Tobacco APH Policy: Unit Structure

• Basic Unit
  – One basic unit for all tobacco acreage in the county, by type, that is owned or cash rented
  – Another basic unit for acreage that is share rented with different landlord
  – 10% basic unit discount

Tobacco APH Policy: Unit Structure

• Optional Unit
  – Subdivided basic units
  – Basic units with two or more FSNs (i.e. one optional unit for each FSN); different practices
  – No 10% discount

• Enterprise Unit
  – Total combined tobacco acreage, regardless of no. of farms or share arrangements
  – 10%-20% discount depending on acreage

Tobacco APH Policy: Quality Adjustment

• Provides reduction to the value of harvested tobacco if damaged
  – i.e. lowers production-to-count (actual yield x quality adjusted price)
Proposed Amendments

- May 2007 Federal Register – RMA presented proposed amendments to flue-cured tobacco policy (due to elimination of tobacco program)
- Main changes:
  - Combine flue-cured & burley into one tobacco policy (but recognize type)
  - Only allow basic units
  - Limit quality adjustment

Proposed Amendments

- Only allow basic units
  - RMA’s argument – majority of tobacco now grown under contract
  - Contract only specify total production by type (regardless of FSN)
  - “Verifiable production records will most likely be kept by type” (not by FSN)

Proposed Amendments

- Limited quality adjustment
  - Applied only if price of damaged crop is less than 75% of producer’s price (if $1.52 price, quality damage to $1.14)
  - Notify insurance company before delivery to determine extent of damage
  - No disinterested third party available to grade and value the crop (with elimination of tobacco program)
Concluding Thoughts & Recommendations

• Consider at least minimum coverage (50%)
  – Fairly stable production
• Consider APH policy with buy-up coverage levels
  – If more risk averse (wants higher protection)
    - Consider premium costs at higher coverage
  – More variable production
  – Not very diverse (only tobacco)

Concluding Thoughts & Recommendations

• Use as many optional units as possible
  – More flexibility
• Contact your insurance agent for more details about the policies
• Contact RMA or Commodity Groups to share your thoughts on proposed amendments

Additional resources

• USDA-RMA Website (http://www.rma.usda.gov)
  – Fact Sheets; Premium Calculators
  – Official Announcements
• USDA-RMA Raleigh Regional Office
  – Information pertaining to North Carolina
• NC State Crop Insurance Website
  – http://www4.ncsu.edu/~rmrejesu/ncsu_crop_insurance_extension_page.htm
  – I will put my presentations & extension materials here
More Questions?

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