FARM BUSINESS MANAGEMENT

FARM ECONOMICS Facts & Opinions

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CROP INSURANCE AND MARKETING DECISIONS

The deadline for signing up for crop insurance is March 15th. By this date, farmers must choose between one of the six crop insurance products available in Illinois: Actual Production History (APH), Revenue Assurance (RA), Income Protection (IP), Crop Revenue Coverage (CRC), Group Risk Plan (GRP), and Group Risk Income Plan (GRIP).

Two factors should influence the crop insurance decision. The first is the type of marketing strategies a farmer engages in prior to harvest. The second is the financial position of the farm, which influences the choice between "farm" level policies and county level policies.

Marketing and Crop Insurance

Generally, a farmer must protect against both price declines and yield losses to provide effective protection against low gross revenues. This can either be accomplished by 1) purchasing yield insurance and also engaging in some pre-harvest hedging, or by 2) purchasing revenue insurance. Pre-harvest hedging includes contracting for forward delivery, selling futures contracts, contracting using hedge-to-arrive contracts, or buying put options.

The pre-harvest hedging portion of the above general recommendation becomes less important when prices are below loan rates, as is the case with soybeans this year. When prices are below loan rates, the Loan Deficiency Payment (LDP) and Marketing Loan Programs already provide protection against lower prices. Hence, it is not critical to have the price protection offered by pre-harvest hedging.

Revenue Insurance and Marketing

Pre-harvest marketing also influences the type of revenue insurance a farmer should purchase. There are two general types of revenue insurance:

1. Revenue insurance without a guarantee increase (i.e., Income Protection (IP) and Revenue Assurance with the base price option (RA-BP)). These insurance should be used by producers who do not aggressively hedge by selling futures contracts or by forward contracting. As a guideline, aggressive hedging means contracting more than 30 percent of expected production prior to harvest.

2. Revenue insurance with a guarantee increase (i.e., Crop Revenue Coverage (CRC) and Revenue Assurance with the harvest price option (RA-HP)). Theses insurances should be used by producers who aggressively hedge.

The guarantee increase offered by CRC and RA-HP causes the revenue guarantee to increase when harvest prices are above base prices (set in February). When prices rise, farmers who hedge are losing money on their hedges. The guarantee increase causes the insurance policies to make payments in cases when yields decline. These payments can cover hedging losses.

The policies without the guarantee increase do not offer this protection. Not having this protection can cause pre-harvest hedging to eliminate the risk protection offered by IP and RA-BP.

Farm or County Level Products

Two insurance products provide protection at the county level. Group Risk Plan (GRP) makes payments when county yields fall below a yield guarantee. Group Risk Income Plan (GRIP) makes payments when county revenues falls below a revenue guarantee.

GRP and GRIP's net costs -- per acre costs of the product minus expected payments from the insurance products – are lower than products that provide protection at the farm level (APH, IP, RA, and CRC). Often, expected payments from GRP and GRIP exceed the premiums paid for the products.

However, GRP and GRIP often offer less risk protection than the farm level products. Therefore, GRP and GRIP should only be used by farmers in strong financial positions where one adverse year does not cause irreversible harm to the farm business. GRP and GRIP also works best for farms whose yields closely track county yields.

Summary

Below are the insurance policies and characteristics of farmers who should select those insurance products:

APH -- use pre-harvest hedging, moderate to vulnerable financial position
IP -- limited use pre-harvest hedging, moderate to vulnerable financial position
RA-BP -- limited use pre-harvest hedging, moderate to vulnerable financial position
RA-HP -- aggressively use pre-harvest hedging, moderate to vulnerable financial position
CRC -- aggressively use pre-harvest hedging, moderate to vulnerable financial position
GRP -- use pre-harvest hedging, strong financial position
GRIP -- limited use of pre-harvest hedging, strong financial position

More information on crop insurance products is available at farm.doc (www.farmdoc.uiuc.edu).

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