

February 28, 2005

FEFO 05-04

Crop Insurance Decisions in 2005

Farmers and share-rent landlords have until March 15th to make changes to their crop insurance programs. This article provides an update for making 2005 decisions. Three topics are covered: 1) changes in crop insurance programs in 2005, 2) group product update, and 3) crop insurance considerations given the possibility on soybean rust.

Crop Insurance Changes in 2005

When making crop insurance decisions, farmers have the same products to choose from in 2005 as in 2004. Moreover, there have been no major changes in provisions of the existing crop insurance programs.

Base Prices: While provisions have not changed, base prices are lower in 2005. These base prices are used to set guarantees on revenue products and are based on settlement prices of Chicago Board of Trade futures contracts. The average of settlement prices during February of the December corn contract is used to determine the corn base price while the November contract is used for the soybean base price. In 2004, base prices were \$2.83 for corn and \$6.72 for soybeans. In 2005, base prices are likely to be around \$2.30 for corn and \$5.50 for soybeans.

Base prices are used to calculate revenue guarantees. The revenue guarantee equals the base price times the Actual Production History (APH) yield times the coverage level. Since base prices have declined, per acre revenue guarantees also will be lower in 2005 as compared to 2004.

Premiums: In 2005, premiums on most crop insurance products will be lower than in 2004. Base prices and price volatilities enter into the calculation of premiums, with lower base prices and lower volatilities leading to lower premiums. As described above, base prices in 2005 will be lower than 2004, leading to lower premiums. In addition, price volatilities are likely to be lower in 2005, again leading to lower premiums.

The largest declines occur for revenue products with guarantee increases. For Crop Revenue Coverage (CRC) and Revenue Assurance with the harvest price option (RA-HP) products, premiums on higher coverage levels are \$4 to \$7 per acre lower in 2005 as compared to 2004. Premiums on Group Risk Income Plan with the harvest revenue option (GRIP-HR) at the 90% coverage level are \$4 to \$7 lower in 2005 than in 2004. Premium reductions are less for lower coverage levels and for revenue products without guarantee increases (i.e., GRIP without the harvest revenue option (GRIP-NoHR) and Revenue Assurance with the base price option (RA-BP).

These changes suggest reconsidering coverage levels. Higher coverage levels may be warranted to counter the decline in revenue guarantees. Moreover, premiums costs will be lower, leading to some

incentive to increase coverage levels.

Group Products

Considerable interest has been expressed in group products, primarily because group revenue products will make large payments in many Illinois counties in 2004. Within the group product class, the three options are:

1. Group Risk Plan – a yield insurance,
2. Group Risk Income Plan without a harvest revenue option (GRIP-NoHR) – revenue insurance without a guarantee increase, and
3. Group Risk Income Plan with the Harvest Revenue option (GRIP-HR) – revenue insurance with a guarantee increase.

More detail on these products, along with premium and expected payout comparisons for these products are provide in the crop insurance section of *farmdoc* (www.farmdoc.uiuc.edu).

We have calculated the net costs, equaling farmer-paid premiums minus payments, for these products (see calculators in http://www.farmdoc.uiuc.edu/cropins/group_crop_products.html). Our estimates suggest that net costs are negative, meaning that over time payments from these products exceed farmer-paid premiums. Generally, net costs are the lowest for GRIP-HR followed by GRIP-NoHR, followed by GRP. If the largest return is desired, GRIP-HR is the logical choice in most Illinois counties. However, premiums follow the reverse pattern. GRIP-HR has the highest premiums followed by GRIP-NoHR, followed by GRP.

A general rule of thumb is that GRP pays in years of low yields, GRIP-NoHR pays in years of low prices, while GRIP-HR pays in both years of low yields and low prices. One could base the product choice on the belief of what will happen during the upcoming production year.

There may be reasons to favor GRIP-HR in 2005. Expected prices used to set revenue guarantees are lower this year which may suggest that there is more possibility of price increases during the fall. Moreover, soybean rust may cause widespread yield declines which could result in a supply induced price increase. This would result in GRIP-HR having larger payouts than GRP or GRIP-NoHR.

Soybean Rust and Crop Insurance

The occurrence of soybean rust could cause declines in yields that trigger insurance payments. Given that soybean rust is a possibility, farmers may wish to re-consider there soybean rust insurance policies. Three suggestions are:

1. Increase coverage levels. In general, farmers have used lower coverage levels for soybeans than for corn. In fact, many farmers have not insured soybean acres. In 2004, 44% of the soybean acres in Illinois were either not insured or were insured using CAT coverage. In most years, using higher coverage levels on corn is prudent because corn revenue is more variable than soybean revenue. The possibility of soybean rust suggests that possibility of low soybean revenues has increased. One way of mitigating this risk is to increase coverage levels on soybean crop insurance products.
2. Purchase either revenue products with guarantee increase provisions (i.e., RA-HP, CRC, or GRIP-HR) or yield products (APH or GRP). Soybean rust could cause lower yields, suggesting that farmers face additional downside yield risk. Revenue products with guarantee increases and yield products provide more yield protection than revenue products without guarantee increases (RA-BP or Income Protection (IP)). Moreover, soybean rust could be widespread in the Midwest. If widespread,

soybean production may decline leading to higher prices. Higher prices could counter lower yields, causing revenue products without guarantee increases (RA-BP and IP) to not make payments. This suggests purchasing either yield insurance or revenue insurance with a guarantee increase.

3. Purchase GRIP-HR or GRP. Soybean rust is likely to be widespread in a county, causing the average county yield to decline. This suggests that group products will make payments if soybean rust occurs. The added benefit of using group products is that farmers can expect to receive more in payments over time than are paid into the product

Coverage concerns with soybean rust: Soybean rust may cause yield losses resulting in insurance payments. Rust-induced losses are covered by multi-peril products as long as good farming practices are used. The Risk Management Agency (RMA), the agency regulating crop insurance, may question whether good farming practices are being followed if a farmer chooses not to spray a fungicide when soybean rust is in an area.

Situations may arise when a farmer may choose not to spray for soybean rust even if rust is known to be in an area. Several possibilities are:

1. Fungicides are not available for application. If this occurs, documenting attempts to purchase fungicide may provide evidence that fungicides were not available. A log of calls to suppliers could provide this evidence for RMA.
2. Custom applicators are too busy to apply fungicide in a timely fashion. Documenting that attempts were made to engage custom applicators seems warranted to provide RMA with information that good farming practices are being followed.
3. Weather conditions may prevent application. Again, documentation of prohibiting weather conditions seems warranted.

Good farming practice concerns are not likely to arise in most cases. Hence, this concern should not be over-estimated. Documenting actions to control rust seems to be a prudent idea. A farmer may also wish to keep a log of soybean rust scouting activities. This record could prove beneficial if good farming practice concerns arise.

Further information

Further information on crop insurance products is available in the crop insurance section of *farmdoc*. This information includes premiums by county, evaluations of risk reduction by county under different crop insurance products, and descriptions of crop insurance products.

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