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Crop Insurance Decisions in 2007

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This year's higher commodity prices will have impacts on crop insurance products that are revenue based. Specifically, base prices used in determining revenue guarantees are going to be considerably higher than in recent years.

Base prices are used to set minimum guarantees on all revenue products including Crop Revenue Coverage (CRC), Revenue Assurance (RA), and Group Risk Income Plan (GRIP). For CRC and RA, the guarantee equals the Actual Production History (APH) yield times the base price times a coverage level. For GRIP, the minimum revenue guarantee equals the expected county yield times the base price times a coverage level.

Base prices are set each year by averaging futures settlement prices during the month of February. The December contract is used for corn and the November contract is used for soybeans. Using settlement prices from February 1 through February 15th results in a base price for corn of \$3.97. This compares to a 2006 base price of \$2.59. The actual base price will differ from \$3.97 because settlement prices during the last half of February will enter into its calculation. While not known with certainty, it is safe to say that the 2007 price will be close to \$4.00. Similarly, the average of the February 1st through 15th settlement prices results in a base price estimate for soybeans of \$7.96. Last year, the soybean base price was \$6.18.

Higher base prices will have two impacts on revenue products. The first is that they will increase the revenue guarantees offered by the insurance products. Take, as an example, a farm that has a 160 bu. Actual Production History (APH) yield and uses a 75% coverage level. Last year, a 75% coverage level would have resulted in a minimum guarantee of \$311 (160 bu. APH yield x \$2.59 base price x .75 coverage level). A \$3.97 base price results in a minimum revenue guarantee of \$476 per acre (160 bu. APH yield x \$2.59 base price x .75 coverage level). At this coverage level, revenue guarantees will be around \$165 per acre higher in 2007 than in 2006.

The other impact of higher base prices is that insurance premiums will increase. Estimates put the increase at between 40 and 70%. For example, an insurance policy that cost \$12 per acre in 2007 will cost in the range of \$15 and \$17 per acre in 2007. Insurance premiums will increase because higher prices cause the amount of insurance to increase, leading to higher premium rates. Moreover, estimates of volatility enter into the calculation of premiums. Volatility measures the chances that prices will move downward. In 2007, volatility estimates likely will be higher for corn than in 2006, resulting in higher insurance premiums.

Farmers will need to take into account higher premiums and higher guarantees when making crop insurance decisions. While the premiums are considerably higher this year, revenue products offer the possibility of placing revenue guarantees at high levels. On many farms, guarantees will exceed the costs of production. In essence, crop insurance allows profits to be assured in 2007. It is rare that crop insurance can be used to set guarantees resulting in profits.