# Crop Insurance Payouts Will Help Cover Losses, But No Free Lunch

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As hot, dry conditions persist across much of the United States, more people are wondering just how severe the damage will be? Will this drought be as severe as 1988, which continued into 1989 and caused an estimated $60 billion in damages, or potentially worse? And how much of the losses will crop insurance companies be paying out in claims?

Anecdotal evidence of the losses, from our readers and others, has been plentiful. We've heard from producers in Missouri who planted, without ever seeing seeds sprout. Others report that their corn fields might look relatively good on the outside, but will have much lower yields due to hot, dry conditions during crucial silking periods, leaving significantly fewer kernels on each ear.

Based on the 2010 value of production, over two-thirds of all crops and two-thirds of all livestock are in areas that are experiencing at least moderate drought, according to USDA. But, as Agriculture Secretary Tom Vilsack noted recently after touring Iowa farms, "it's somewhat guesswork at this point in time in terms of what the overall yields will be for the country." The former Iowa Governor saw everything from "significant damage, to crops that looked in pretty good shape." For example, some growers in Minnesota are looking at healthy stands of corn and soybeans with expectations of higher than normal yields.

"Certainly, new seed technology and the fact that U.S. producers have planted 5 million more acres in corn across the country this year provides some degree of mitigation, but certainly not enough to overcome the impact of this rather severe drought," Vilsack added.

**Improved safety net**

The good news for most crop growers is that there is a better financial safety net than they had 24 years ago during the last major drought. So even though they may have made major investments in crop insurance premiums, seed, fertilizer and other inputs, they should be able to repay most operating loans this year. That's why there has been little, if any, demand for ad hoc disaster assistance – outside of the livestock community.

"We have a crop insurance program where you can insure up to 85 percent of your crop, you can insure your revenue up to 85 percent," USDA Chief Economist Joe Glauber recently explained. "You can get indemnified. If you bought crop insurance policies with harvest time prices, you can get indemnified at harvest prices. If we look at December futures for corn or November futures for beans, those would be good prices to get an indemnity payment based on right now."

There is a major change in the 2012 crop insurance contract that will add to payouts for farmers who suffered losses, points out Kansas State University Ag Economist Art Barnaby.

"In many of the Corn Belt states, the farmers' actual production histories (APH) were adjusted up for trend yield. Because of those higher APHs, the claims will be higher than the historical claims that were based on a simple 10-year average yield," he said.

But at the same time, Barnaby says insurance, in most cases, does not make farmers whole.

"This is not the free lunch being painted by critics," Barnaby pointed out in a recent Kansas State University web post. "Nearly all farmers will be better off with a crop than insurance payments."

Producers with revenue protection for corn acres contracted for a guaranteed minimum price of $5.68 for whatever percentage they insured. The final recovery price will be the average of the October prices on the December corn futures, but there is a cutoff point for revenue protection recovery. Because of a cap placed by USDA, the recovery cannot go more than double the guaranteed price, points out Ray Massey, University of Missouri Extension.

"If it were to get up to $11.36 a bushel, the insurance company will be required to cap the price," Massey said. "But I don't know anybody that's calling for $11 per bushel of corn." At least not yet.

However, not all farmers purchased the highest levels of coverage and are finding out the hard way that they will not be eligible to receive some of the highest indemnities.

"Without the harvest price option, there is no upside price protection," warned Auburn Insurance Agent Ruth Gerdes in presentations to growers earlier this year. But now she's getting calls almost every day from farmers who aren't her customers and didn't understand that if they excluded the harvest price option, their bushel guarantee goes down significantly.

"And they are in a world of hurt," she adds.

University of Illinois Agricultural Economist Gary Schnitkey developed Table 1 (below) to demonstrate how, based on last year's experience, the potential for large insurance payouts can vary. Given the drought conditions, harvest prices will likely be above the $5.68/bu. projected price. In this example, insurance payments at a $6.50 harvest price would be $20/acre for a 145 bu./acre yield, $150/acre for 125 bu./acre yield and $280 per acre for 105 bu./acre yield.

**Table 1 Per Acre Insurance Payments for a Revenue Protection Policy at an 80% Coverage Level with a 185 Bushel Trend-Adjusted Actual Production History Yield and a $5.68 Projected Price.**

| Harvest Yield | Harvest Price | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 3.00 | 4.10 | 4.40 | 4.70 | 5.00 | 5.30 | 5.60 | 5.90 | 6.20 | 6.50 | 6.00 | 7.10 | 7.40 | 7.70 |
| 85 | 518 | 482 | 497 | 441 | 410 | 380 | 356 | 372 | 331 | 410 | 428 | 447 | 466 | 486 |
| 95 | 480 | 451 | 423 | 394 | 366 | 337 | 309 | 313 | 329 | 345 | 360 | 376 | 392 | 408 |
| 105 | 443 | 410 | 379 | 347 | 316 | 284 | 253 | 254 | 267 | 280 | 292 | 305 | 318 | 331 |
| 115 | 404 | 368 | 335 | 300 | 266 | 231 | 197 | 196 | 205 | 215 | 224 | 234 | 244 | 254 |
| 125 | 366 | 326 | 291 | 253 | 216 | 178 | 141 | 138 | 143 | 150 | 156 | 163 | 170 | 177 |
| 135 | 328 | 287 | 247 | 206 | 166 | 126 | 86 | 77 | 81 | 85 | 88 | 92 | 96 | 100 |
| 145 | 290 | 246 | 203 | 159 | 116 | 72 | 29 | 18 | 19 | 20 | 20 | 21 | 22 | 23 |
| 155 | 252 | 206 | 159 | 112 | 66 | 19 | | | | | | | | |
| 165 | 214 | 164 | 115 | 65 | 16 | | | | | | | | | |
| 175 | 176 | 123 | 71 | 18 | | | | | | | | | | |
| 185 | 138 | 82 | 27 | | | | | | | | | | | |
| 195 | 100 | 41 | | | | | | | | | | | | |
| 205 | 62 | 0 | | | | | | | | | | | | |
| 215 | 24 | | | | | | | | | | | | | |

Source: Table generated using 2012 Crop Insurance Decision Tool available for download in the FAST section of farmdoc (www.farmdoc.illinois.edu).

In Table 1, boxes are placed around two payments representing the drought years of 1983 and 1988. For these years, the percent deviation in actual yield from trend-line yield in Illinois and the percent change in harvest price from project price were calculated and applied to 2012 conditions. If a year similar to 1988 occurs in 2012, yield would be 105 bushels per acre and harvest price would be $7.40/bu., resulting in a $318/acre insurance payment.

Producers with corn or soybean delivery contracts face a different dilemma. "Hopefully, they didn't contract very much," Massey said. "If they have a contract that they're not going to be able to fill, they are still legally obligated." Unless the producer chooses to default on the contract and risk going to court, they have two options.

"They will need to purchase corn on the market and deliver it, or they can negotiate a settlement price for the contracted corn," Massey said. Soybean producers face the same situation, he adds, while noting that producers must contact their insurance agent before making any decision to prevent voiding their coverage. Δ

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