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# 2008 Farm Bill: Implications for Risk Management

Stephen Frerichs  
February 21, 2008  
Arlington, VA  
Outlook Conference

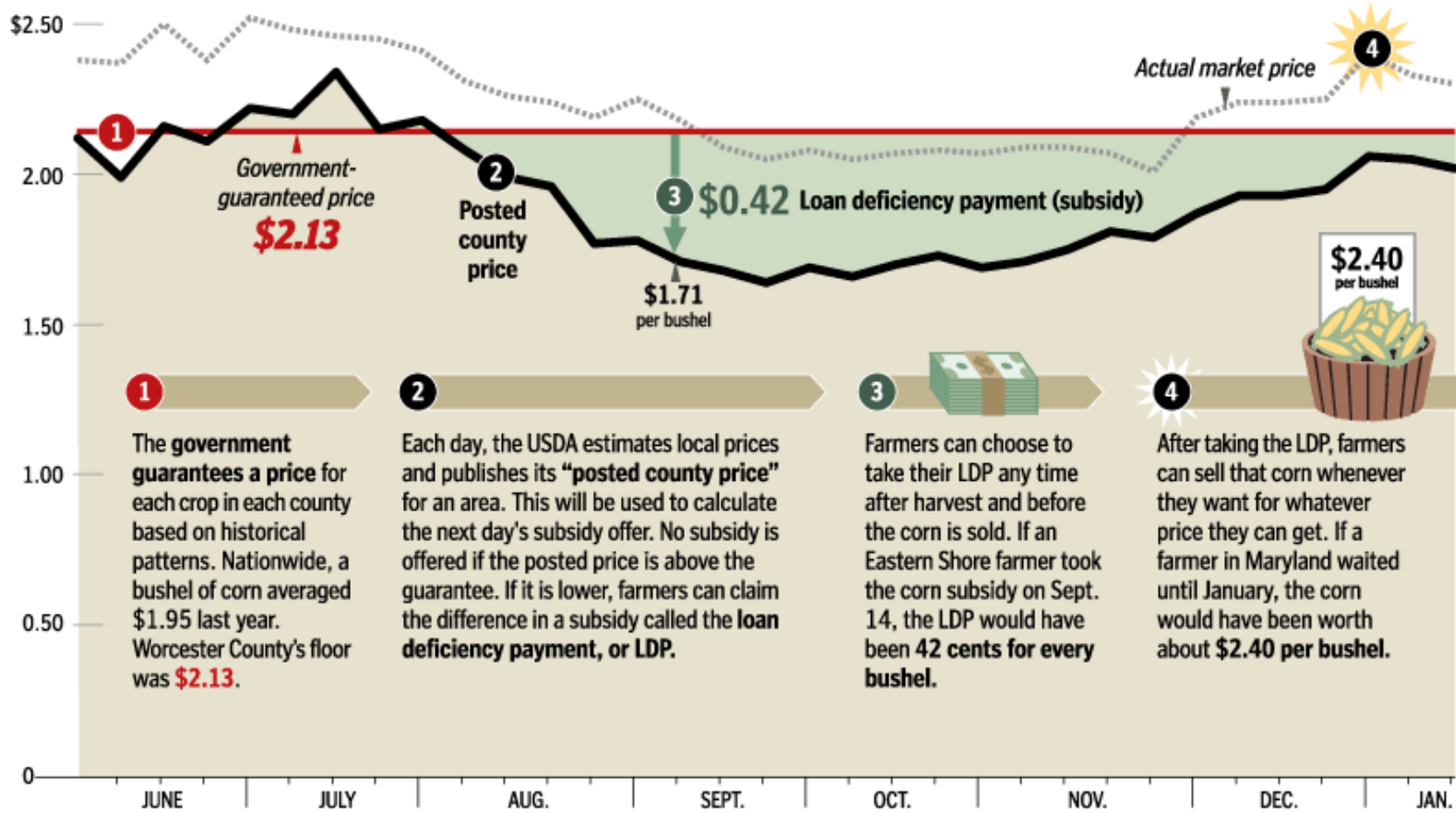
# Risk Transfer

- Price
- Yield
- Revenue
- Life, home, health, property

# Risk Transfer

- Price
  - LDPs/ non-recourse loans
  - Countercyclical payments
  - Crop insurance revenue products –  
CRC, RA, IP, GRIP

Sale price for one bushel of Eastern Shore corn in 2005



**1** The **government guarantees a price** for each crop in each county based on historical patterns. Nationwide, a bushel of corn averaged \$1.95 last year. Worcester County's floor was **\$2.13**.

**2** Each day, the USDA estimates local prices and publishes its **"posted county price"** for an area. This will be used to calculate the next day's subsidy offer. No subsidy is offered if the posted price is above the guarantee. If it is lower, farmers can claim the difference in a subsidy called the **loan deficiency payment, or LDP**.

**3** Farmers can choose to take their LDP any time after harvest and before the corn is sold. If an Eastern Shore farmer took the corn subsidy on Sept. 14, the LDP would have been 42 cents for every bushel.

**4** After taking the LDP, farmers can sell that corn whenever they want for whatever price they can get. If a farmer in Maryland waited until January, the corn would have been worth about **\$2.40 per bushel**.

**The Result**

A farmer would get to keep the subsidy of 42 cents, even though the sales price was 13% percent above the government-guaranteed minimum.

**Subsidy**  
\$0.42 per bushel

**+**

**January sale**  
\$2.40 per bushel

**=**  
**\$2.82** per bushel

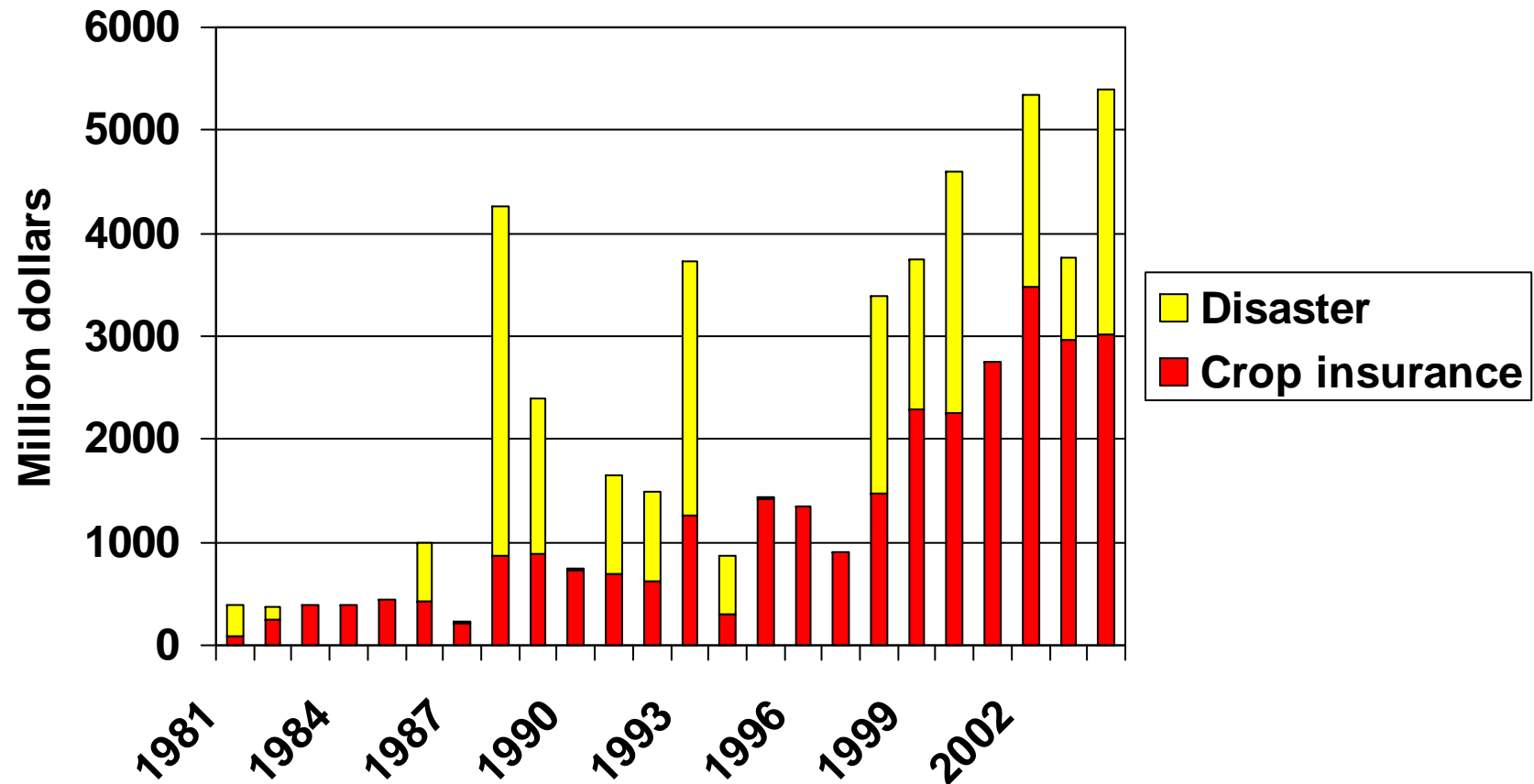
# What happens if target prices no longer matter?

- High input prices
- Greater volatility
- Crop insurance revenue products only tool that transfers risk during high price environment
- Shift to revenue focus

# Risk Transfer

- Yield
  - Crop insurance
  - NAP
  - Ad hoc disaster assistance

# Total Outlays Crop Insurance and Ad-hoc Disaster Assistance



Source: Joe Glauber, Double Indemnity Paper 2007



# Permanent Disaster

- Disaster Payment =  $55\% * \text{disaster program guarantee} - (\text{total farm revenue} + 20\% \text{ of direct payment received})$
- Disaster Guarantee (Insurable Crop) =  $\text{Highest yield} * \% \text{ of crop ins yield guarantee} * \text{crop ins price} * 115\%$
- Disaster Guarantee (Noninsurable Crop) =  $\text{NAP yield guarantee} * \text{NAP price} * 115\%$
- Total Farm Revenue = Estimated value of crops and grazing + crop ins indemnities (gross) + NAP payments

Highest Yield = higher of APH 5-yr Ave or 5 yr Ave county Olympic Ave or counter-cyclical program yield

# Permanent Disaster

- Whole Farm Revenue – all counties, all crops
- Secretarial county disaster declaration
- Payment limit of \$100,000 per farm and no more than 90% of expected revenue per crop
- Favors single crop enterprises over diversified enterprises
- Incentive to buy-down from 80 and 85 coverage
- Incentive to buy crop insurance – probably at better than 50% coverage level

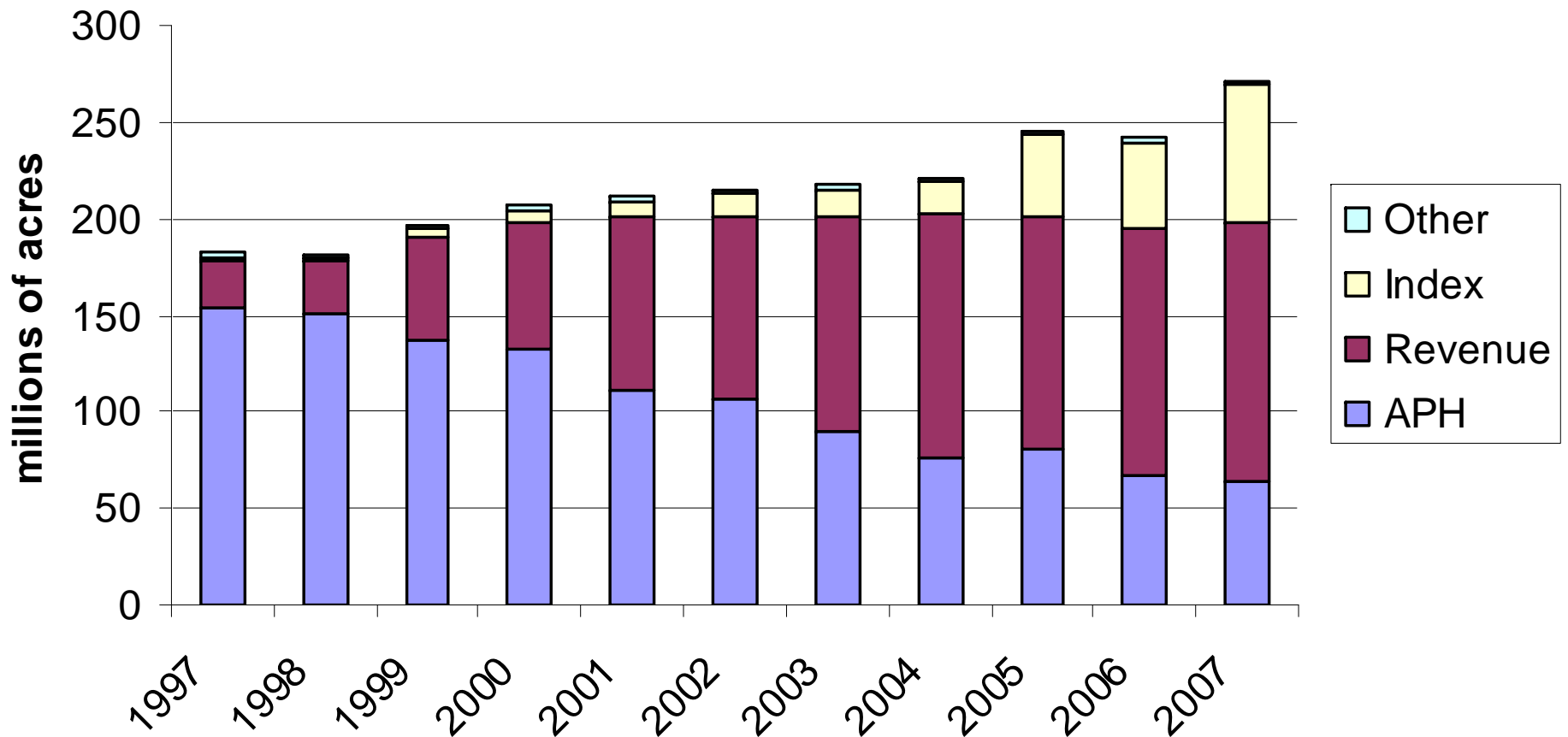
# Disaster Payments

- Shift towards working with, supplementing crop insurance, not replacing it

# Risk Transfer

- Revenue
  - Crop insurance
  - New programs
    - Average Crop Revenue
    - Revenue based countercyclical payments

# Growth in Insurance Revenue Products



# Revenue Countercyclical Programs

- At what level? Basis risk?
  - National
  - State
  - County
  - Individual
- What interaction with crop insurance?

# Conclusions

- High commodity prices are forcing review of traditional commodity programs but change will come slowly since not all commodities are in the same boat. Crop insurance revenue products only policy tool that transfers risk during high price environment.
- The debate about disaster payments has shifted to one of “melding with” crop insurance rather than replacing.
- Revenue countercyclical programs will not work effectively above the individual producer level.

# Outlook

- Revenue policy options will remain focus of debate as long as commodity prices are high.
- Ad hoc disaster payments will continue even with standing disaster program.
- Crop insurance revenue participation remains strong as it is only policy tool that transfer risk in high price environment.