2008 Farm Bill: Implications for Risk Management

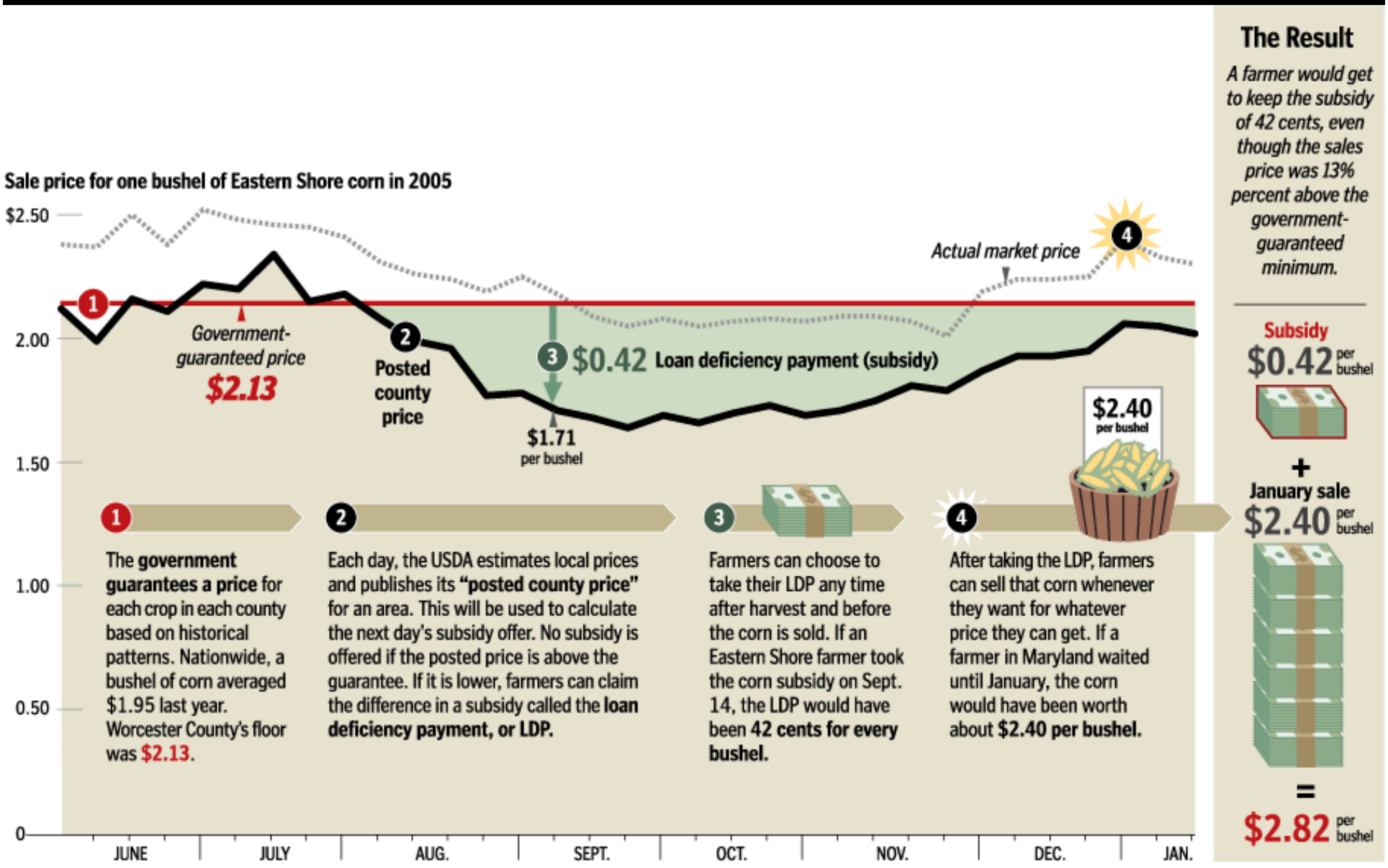
Stephen Frerichs
February 21, 2008
Arlington, VA
Outlook Conference

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



Washington Post July 3, 2006

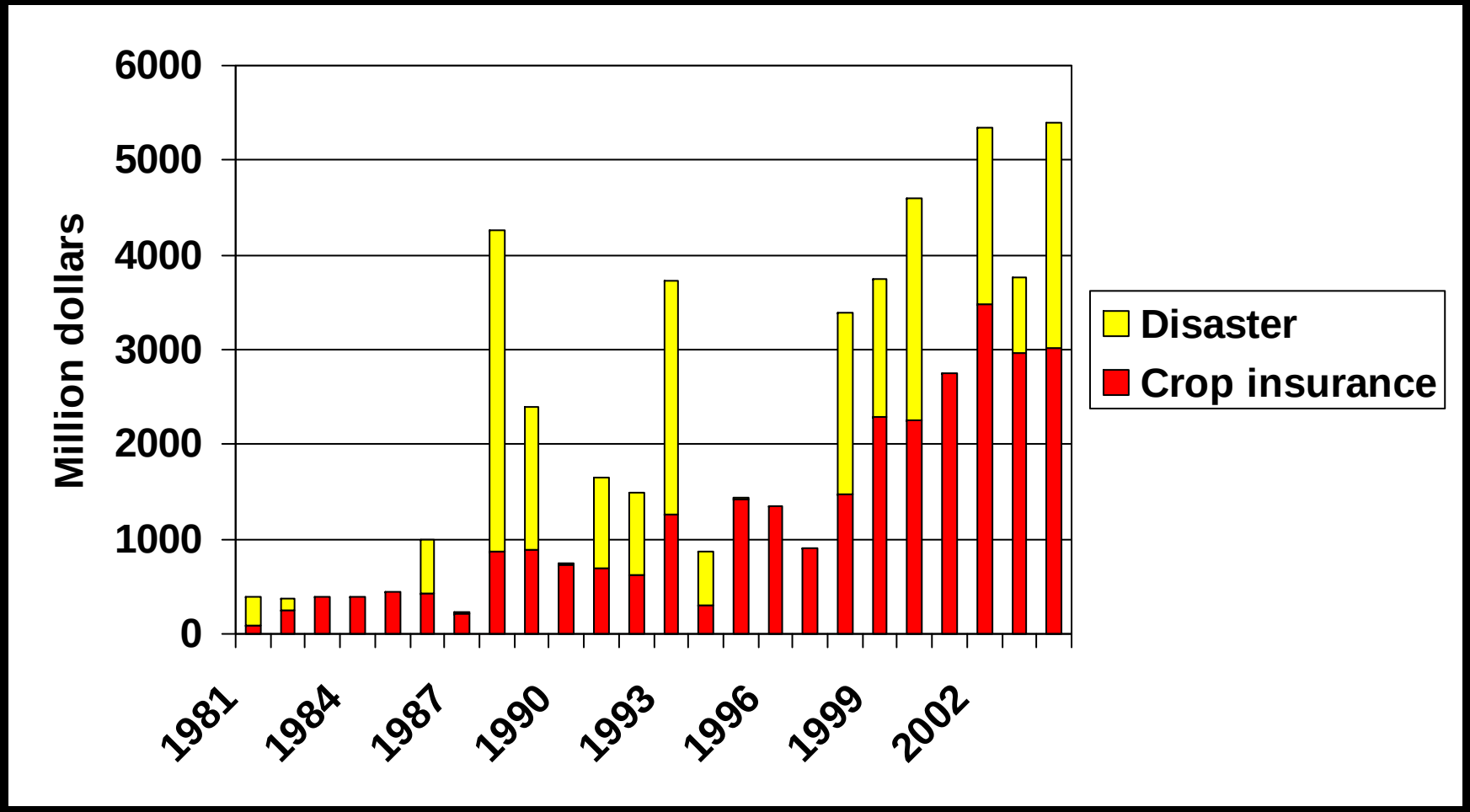
What happens if target prices no longer matter?

- 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% * disaster program guarantee – (total farm revenue + 20% of direct payment received)
- Disaster Guarantee (Insurable Crop) = Highest yield * % of crop ins yield guarantee * crop ins price * 115%
- Disaster Guarantee (Noninsurable Crop) = NAP yield guarantee * 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

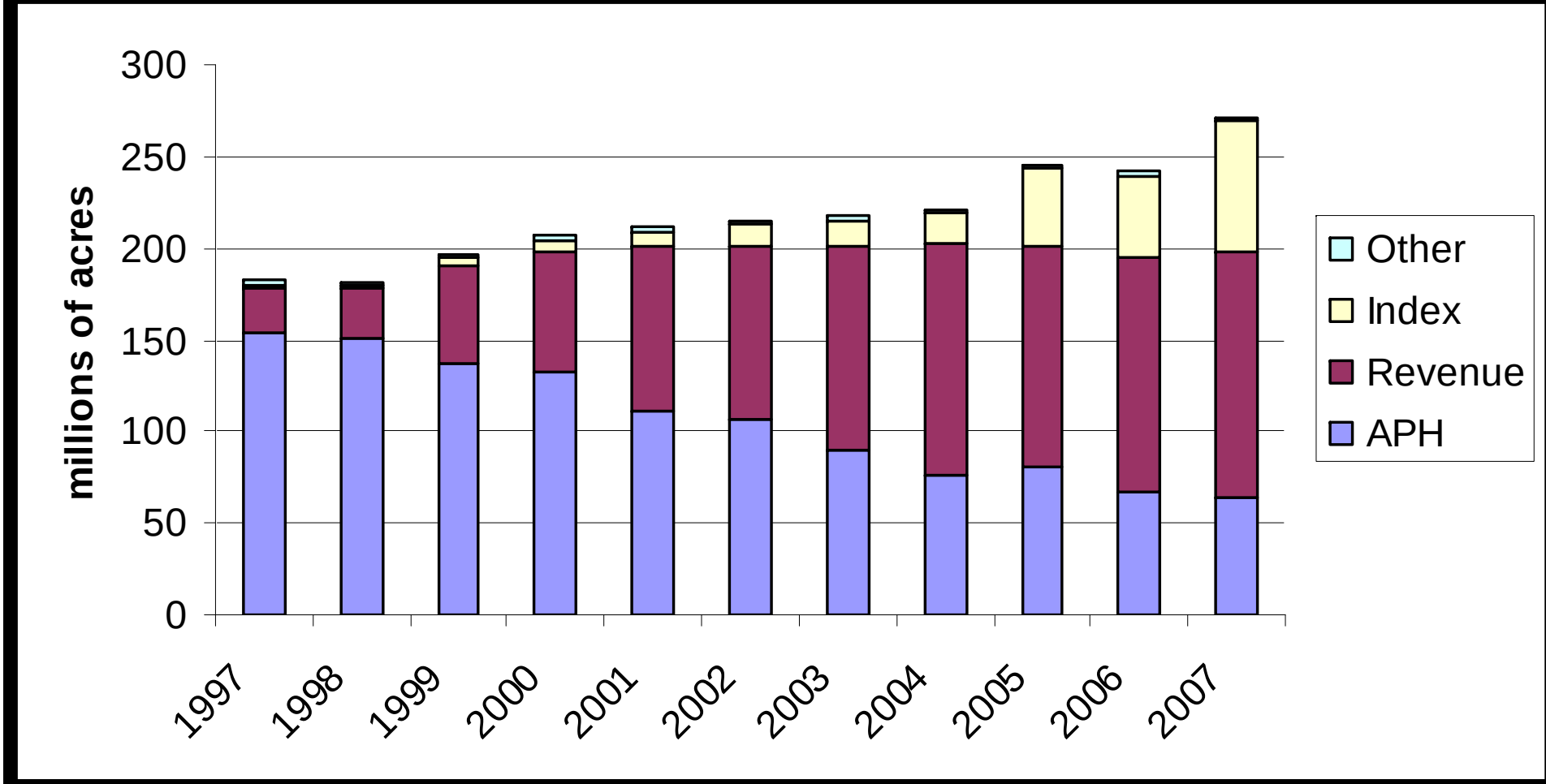
Disaster Payments

- 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.