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Many Wisconsin farmers have forward contracts with a local elevator or ethanol plant or have sold futures contracts on the Chicago Mercantile Exchange. With the current drought, many of these farmers are concerned that they may not have the grain to meet these contracts. Most Wisconsin farmers also buy crop insurance – 69% of corn acres and 74% of soybean acres were insured in 2011, with even more acres likely insured in 2012. Many farmers are wondering: What if I do not have the grain to make delivery on contracts and I have crop insurance? Should I do something now? This bulletin is a quick summary of things to consider.

Don't Panic

The season is far from over. Timely rains can still mean a substantial crop for many growers. Corn is about to move into the crucial pollination phase and soybeans will continue to flower into August, so well-timed rains could still mean sizeable yields this fall – we just need patience to see how the next month or so develops. Each farmer will have to wait and assess yields once these reproductive phases end for their crops. With this information, farmers can then determine if meeting grain delivery obligations will be a problem. Farmers who think they will have shortfalls and will not be able to meet delivery requirements for forward contracts may want to communicate now to see how they will be asked to meet requirements. Will they have to buy grain on the open market, pay transportation, and make delivery themselves or is there some other way to proceed? This information can help farmers make better plans for the future.

Know Your Policy

In the meantime, some farmers may want to make marketing adjustments in response to current high prices. A key issue is to know the specifics of your policy: do you have Revenue Protection, Revenue Protection with the Harvest Price Exclusion or Yield Protection? Look over your policy and/or call your insurance agent to clarify if you do not know. In particular, be sure to know if you have Revenue Protection or Revenue Protection with the Harvest Price Exclusion, as these will likely have different price guarantees this fall.

Revenue Protection

Revenue Protection (RP) is the most popular policy for corn and soybeans in Wisconsin. With RP, the guaranteed revenue increases with the market price. The RP revenue guarantee for corn was calculated using a price of \$5.68/bu this spring, but the final guarantee will be calculated using the average during November of the December corn futures contract on the Chicago Mercantile Exchange (CME). For soybeans, guarantees were determined using a price of \$12.55/bu this spring, but the final guarantee will be determined using the October average of the November soybean contract on the CME. The main point is that, with RP, a farmer will either have the grain at harvest time (if yield losses are not too large) or the money to buy grain at harvest time prices (if yield losses trigger insurance indemnities) to fulfill contracts with delivery

requirements at harvest. Insured farmers that have contracts with later delivery dates and have yield losses can use RP indemnities to buy grain in December and store it until delivery.

Yield Protection

Yield Protection (YP) is another popular crop insurance policy in Wisconsin. YP only pays indemnities if a farmer's harvested yield is less than the chosen yield guarantee, regardless of the price at harvest. For farmers with YP, corn yield losses will be paid using a price of \$5.68/bu and soybean losses with a price of \$12.55/bu, no matter what the price is at harvest. If current market prices continue, farmers with YP who have forward contracts and expect a yield shortfall will likely have to buy grain at higher prices than will be paid by their insurance. These farmers may want to buy futures contracts to offset their price risk, if they think the price at harvest will be higher. This price risk is the same each year for farmers with forward contracts who buy YP. Every year, these farmers bear the risk of having yield losses and having to buy grain at market prices higher than will be paid by their insurance. Farmers concerned about this risk should either buy RP in the spring instead of YP or use existing futures markets to offset their price risk.

Revenue Protection with the Harvest Price Exclusion

Revenue Protection with the Harvest Price Exclusion (RP-HPE) is not a common crop insurance policy in Wisconsin. RP-HPE is the same as RP, except that the revenue guarantee does not increase with the harvest price in the fall. Thus, RP-HPE only protects farmers from price decreases, not price increases. Much like YP, if current market prices continue, farmers who have forward contracts and expect a yield shortfall will likely have to buy grain at higher prices than they will be paid by their RP-HPE policy. These farmers may want to buy futures contracts to offset their price risk, if they think they will have a yield shortage for their delivery contracts and they think the price at harvest will be higher.

Livestock as a Forward Contract

Farmers with livestock essentially have a forward contract with delivery obligations: if they have a yield shortfall, they will have to buy feed for their livestock or sell (part of) the herd. Thus, the same principles explained above apply to these farmers, even if they do not have formal forward contracts. Farmers who do not have RP, if they think prices will be higher than current prices when they will need the grain, should consider buying a forward contract to receive delivery of grain. However, farmers with RP can use indemnities paid in December, calculated at existing market prices, to buy grain and store it for their livestock needs.

Final Thoughts

The drought will likely have significant price impacts, but farmers with a marketing plan do not need to panic. A good marketing plan allows for flexibility and as in any year, adjustments to the marketing plan should be considered. This year illustrates the need for flexibility and the usefulness of crop insurance for managing marketing risk.

For More Information

Contact the authors for more detailed questions. Also, see the UW Extension FYI Drought 2012 web page for a wide variety of information on the drought: <http://fyi.uwex.edu/drought2012/>.