

Reconsidering Risk Management in the Farm Safety Net: A Perspective for 2013



Vincent H. Smith, PhD



Professor of Agricultural Economics

Department of Agricultural Economics and Economics

Montana State University

Farm Programs Are Complex

- In 2001, farmers received Commodity Credit Corporation payments under over 80 different programs managed by FSA.
- Things have only become more complicated with the advent of Countercyclical Payments in 2002, and, in 2008, ACRE, the new suite of five Standing Disaster Programs and innovations in conservation policy, including the Conservation Stewardship Program.

Federal Agricultural Insurance Programs Are Complex

- There are at least 22 different agricultural insurance products (although that number will fall when the two major farm-based revenue insurance programs are combined).
- Within any given product, numerous coverage options are available (several different deductible levels, many crop loss valuation choices, and in some cases quality loss options).
- Each crop has its own suite of products and within product options
- And now, crop insurance decisions directly affect a farm's eligibility for disaster aid payments, and the amount of those disaster aid payments for crop losses.

The Iowa Corn-Soybean Farmer's Safety Net World

- The farm, in Clarke County, has three crops: corn, soybeans, grain sorghum and a hog finishing operation
 - Corn and Soybeans can be insured under APH, CRC, RA, GRIP, or GRP (one farm based yield insurance product, two farm based revenue insurance products, and two area yield products)
 - Grain Sorghum can be insured under APH or CRC
 - The hogs can be insured under Livestock Gross Margin or Livestock Risk Protection

The Iowa Corn-Soybean Farmer's Safety Net World

The farmer has over 150,000 farm wide insurance options between which she or he has to choose

(and the farmer is not done yet with safety net choices, because there is the choice between the FSA commodity programs: ACRE and DCP!)

The DCP/ACRE Choice

- Multi year
- If ACRE is selected, complex annual cropping decisions are important
- If DCP is chosen, options are less complex but still not simple.
- And what about the CRP (a guaranteed income stream for 10-15 years).



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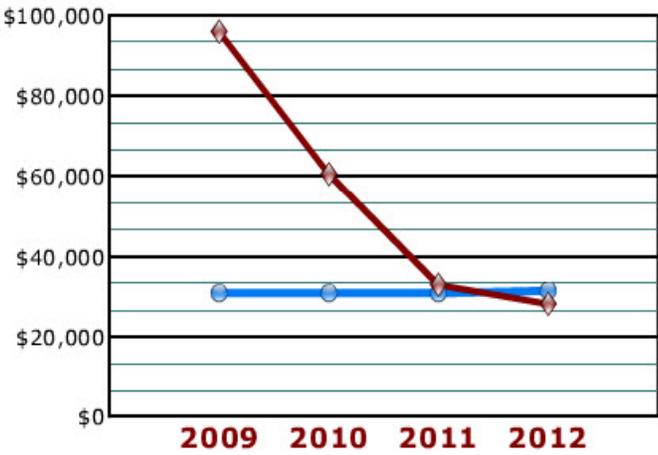
Menu-Display Options

Click to Display/Change Local Cash Values--For LDP Calc--(Off/On)

Percent of Current Single Year State Yields

	National Average Price for a Single Coverage Year					Percent of Current Single Year State Yields			
	2008	2009	2010	2011	2012	100%	100%	100%	100%
Wheat HRS	\$6.780	\$4.850	\$5.000	\$5.250	\$5.500	30.7	30.7	30.7	30.7
Barley Feed-Dry	\$3.820	\$2.400	\$2.500	\$2.500	\$2.500	38.7	38.7	38.7	38.7
Wheat HRW	\$6.780	\$4.850	\$5.000	\$5.250	\$5.500	30.7	30.7	30.7	30.7
AA-Crop Name	\$0.000	\$0.000	\$0.000	\$0.000	\$0.000	0.0	0.0	0.0	0.0
AA-Crop Name	\$0.000	\$0.000	\$0.000	\$0.000	\$0.000	0.0	0.0	0.0	0.0
AA-Crop Name	\$0.000	\$0.000	\$0.000	\$0.000	\$0.000	0.0	0.0	0.0	0.0
AA-Crop Name	\$0.000	\$0.000	\$0.000	\$0.000	\$0.000	0.0	0.0	0.0	0.0

Total Gov. Payments DCP Versus ACRE Program
ACRE + Direct + LDP + CCP Payments



● DCP Program ◆ ACRE Program

Total Payments 2009 - 2012	
DCP Program	\$124,047
ACRE Program	\$217,647

DCP Program Option with 83.3% direct payment rate for 2009-2011 and 85% for 2012

	2009	2010	2011	2012	Totals
ACRE Payments					DCP Option
Direct Payment	\$30,854	\$30,854	\$30,854	\$31,484	\$124,047
LDP Payment	\$0	\$0	\$0	\$0	\$0
CC Payment	\$0	\$0	\$0	\$0	\$0
Total	\$30,854	\$30,854	\$30,854	\$31,484	\$124,047

ACRE Program Option

	2009	2010	2011	2012	Totals
ACRE Cap Adjust	\$6,171	\$0	\$0	\$0	\$6,171
ACRE Payments	\$65,000	\$35,903	\$8,310	\$3,026	\$112,239
Direct Payments	\$24,683	\$24,683	\$24,683	\$25,187	\$99,238
LDP Payment	\$0	\$0	\$0	\$0	\$0
CC Payment					
Total	\$95,854	\$60,587	\$32,993	\$28,213	\$217,647

Basic Policy Perspectives:

I. We Need to be Good Samaritans

Political consensus that:

- Farmers face atypically severe risks
- Farmers have a tough job
- Farmers should be helped when, through no fault of their own, adverse weather and other events cause financial hardship
- So a well-funded farm safety net has widespread support

Basic Policy Perspectives:

II. We Need to be Efficient Good Samaritans

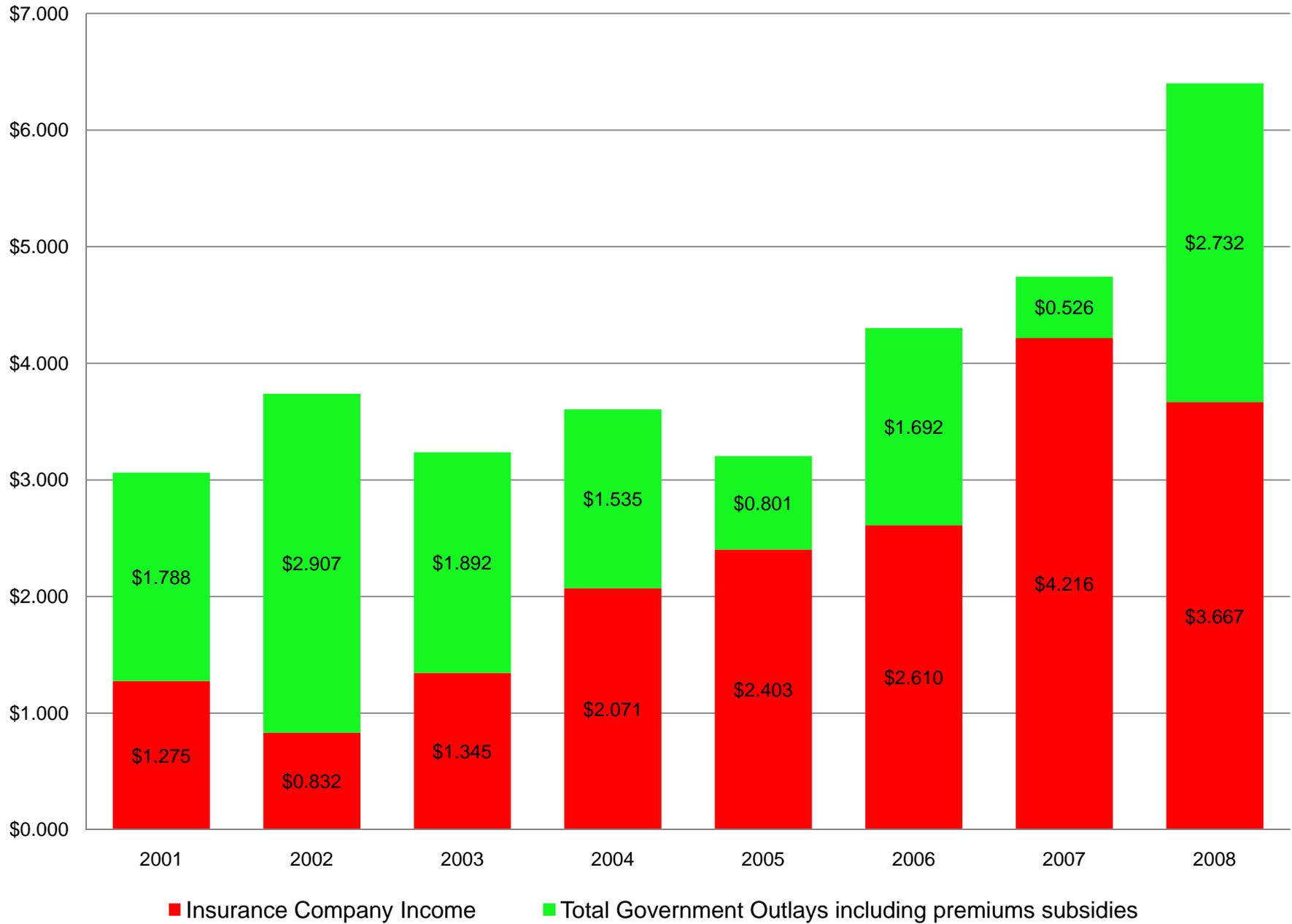
Political consensus that:

- Government programs should be run efficiently and use as few administrative resources as possible.
- Government resources should benefit the people they were intended to help: not others.
- Government programs should be designed to minimize the time and effort it takes for potential beneficiaries to participate in them.

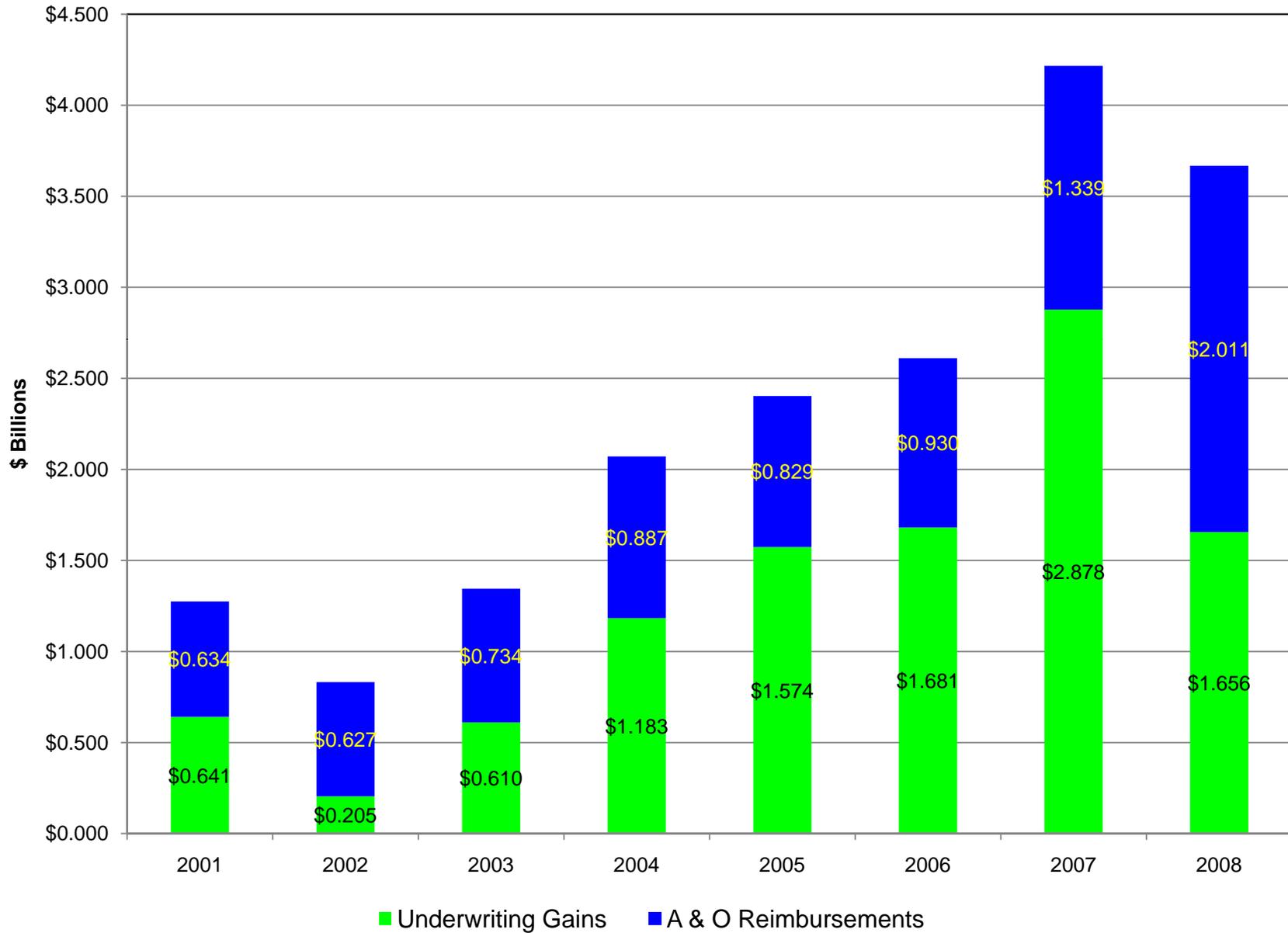
The current farm safety net “may” not be meeting these goals.

Some Partial Data on the Delivery Costs of the Federal Agricultural Insurance Program

Total Government Subsidies and Income Received by Insurance Companies from A&O and Underwriting Gains



Estimated Insurance Company Income by Source: 2001-2008



Other Safety Net Administrative Costs

- RMA Personnel and Other Costs
- FSA Personnel and Other Costs (burden has been significantly increased by ACRE and the new Standing Disaster Programs)
- Burden on Farmers

Are There Lower Cost Alternatives?

A Weather Multi Index Approach

- Internet based delivery system (not zero cost, but not \$3.5 billion either)
- Farm insures against multiple weather related hazards
 - ✓ Lack of precipitation in specific periods (e.g., key growing season months)
 - ✓ Frost in Spring or Fall
 - ✓ Too much precipitation at harvest
 - ✓ Extreme heat during the growing season

A Weather Multi Index Approach

- Subsidies based on estimated expected value of crop (per acre) and receive a fixed percentage of the crop value as a subsidy (same for all crops)

A Weather Multi Index Approach: Advantages

- Data for rate making are relatively plentiful and reliable at about the township level (NOAA).
- Data for assessing indemnities are already collected by a government agency and not readily subject to manipulation.
- Adverse selection issues are addressed relatively cheaply.
- Delivery costs are lower (no need for insurance company loss adjustment services, much less need for marketing services, no economic rationale for risk bearing or underwriting gains by insurance companies)

A Weather Multi Index Approach: Issues and Disadvantages

- Farms' crop planting decisions (in terms of acreage, expected yields, etc) and crop values (quality and price) still need to be determined
- Livestock insurance issues (other than forage production) not addressed
- Catastrophic event consequences (e.g., hurricanes) likely still need to be addressed separately.

A Weather Multi Index Approach: Issues and Disadvantages

- There is a bad miss (basis risk) problem:
 - Losses on the ground are imperfectly correlated with even complex weather indexes (single rainfall indexes don't work well at all)
 - So farmers do not always receive indemnities when they incur losses or indemnities commensurate with the losses they incur

Other Approaches to Address the “Bad Miss” Problem

- Using weather indexes in conjunction with area (county based) yields
- Combing satellite data with weather and area (county yield) data



QUESTIONS