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2013 Annual Meeting Economics and Management of Risk in Agriculture and Natural Resources

Thomas Zacharias, Keith Collins, and Harun Bulut
National Crop Insurance Services
March 15, 2013

Organization of Presentation

- NCIS Background
- 2011 and 2012 Industry Results
- “Seems to Me...” – Or “Letterman’s”
Top 10 (sort of)
- Summary and Conclusions

Industry Role

NCIS serves as the primary service organization for the crop insurance industry

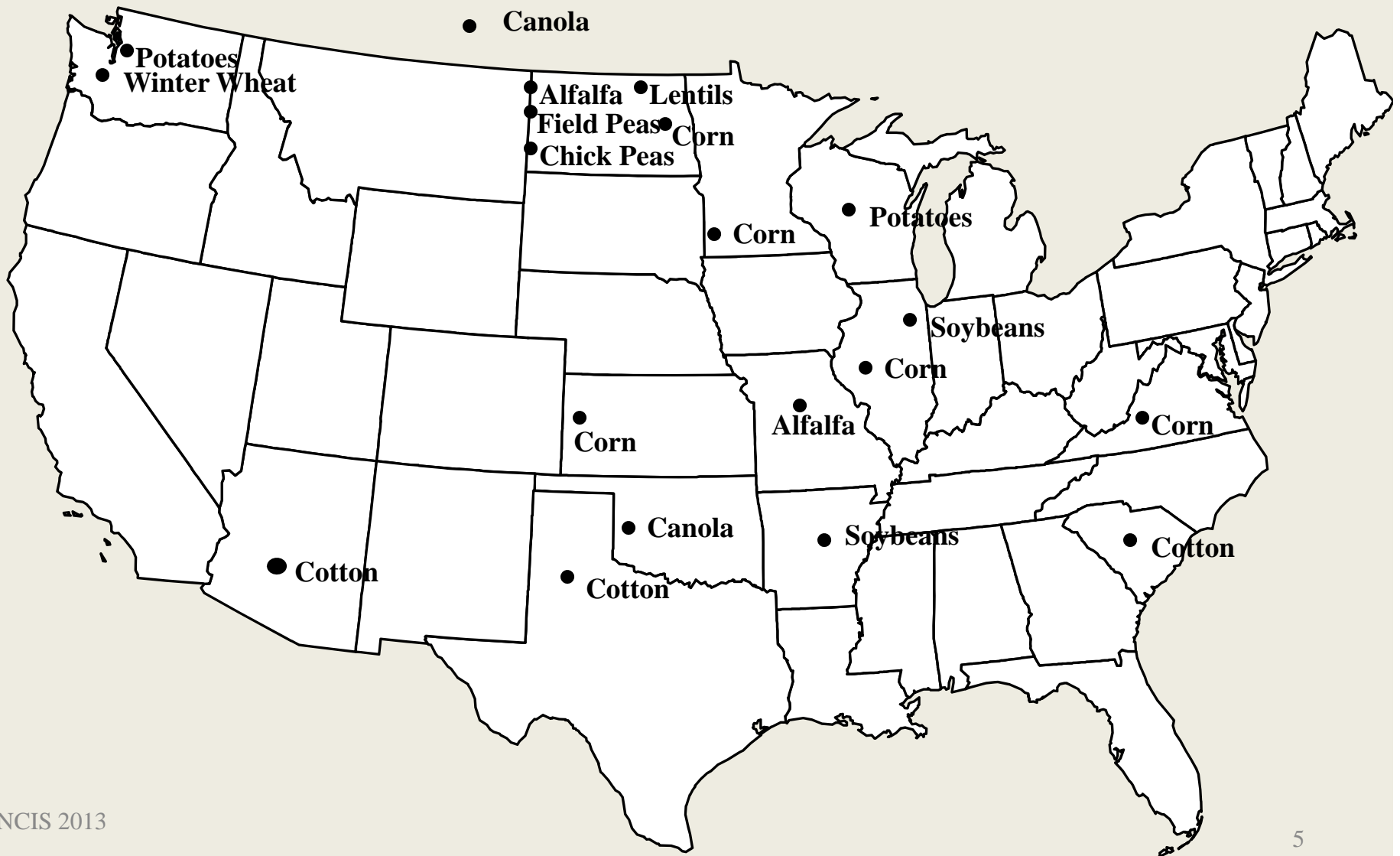
Currently, all AIPs are NCIS members

Origins back to 1915

NCIS Functions

- MPCCI and Crop-Hail Program Development and Analysis
 - Policy Analysis, Loss Adjustment Procedures, Legal Analysis, Agronomic Research
- Economic and Actuarial Analysis
- Education and Training
 - Loss Adjuster Schools – 15 (1,482 attendees)
 - National Conferences – 3 (707 attendees)
 - Annual Regional/State Meetings – 13 (366 attendees)
- Crop-Hail Advisory Organization and Statistical Agent
 - Licensed by Individual State Insurance Department
- Public Relations and Industry Outreach

2013 NCIS CROP RESEARCH

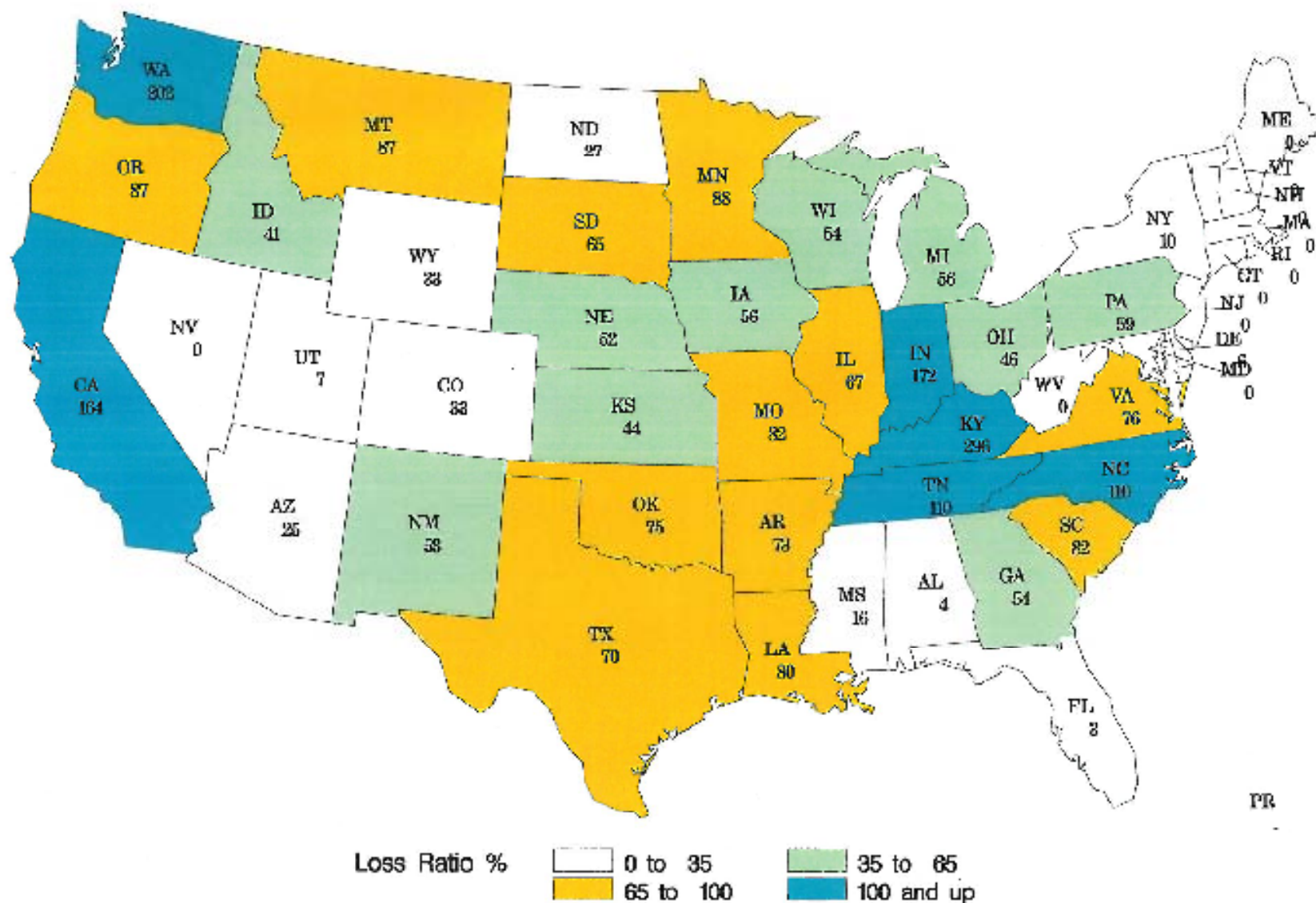


2011 and 2012 Industry Results

Crop Hail		
	Premium	Loss Ratio
2011	\$842M	116%
2012	\$925M	74%
MPCI		
	Premium	Loss Ratio
2011	\$11.97B	91%
2012	\$11.08B	142+%

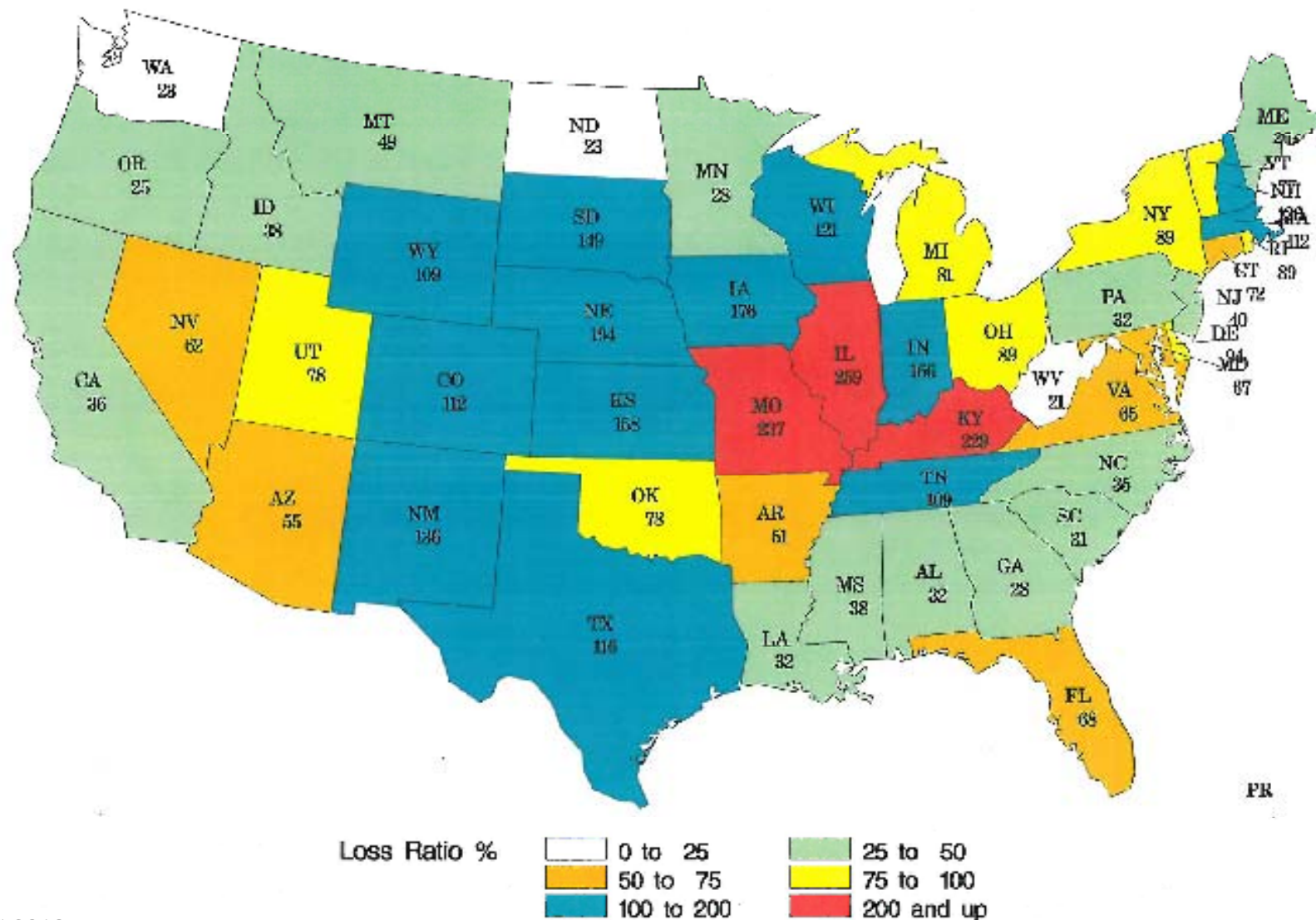
2012 US Crop-Hail Loss Ratio by State

All Crops - All Losses - All Policies



2012 US MPCl Loss Ratio by State

All Crops - All Losses - All Policies



“Seems to Me....”

Or

“Letterman’s” Top 10

1) Do We Believe We Will/Should Have Public Funding For an Agricultural Safety Net?

- Arguments *Against*
 - Based primarily on free market perspective and lack of major externalities or market failures
- Arguments *For*
 - Market failures (systemic risk, information asymmetries)
 - Desire to help stabilize the production sector (might not occur if cost prohibitive)
 - Benefits to sector stability to allied industries and the rural economy
 - Political reasons (politicians help an industry composed of millions of small businesses when natural disaster occurs)
 - Food is necessity

2) Should The Safety Net Be Administered Ex Ante or Ex Post?

- Definition of Terms – Is ex ante a mandatory program and ex post an appropriated program? If so, ex ante is easier on the budget process than attempting supplemental appropriations.
- Ex ante provides for personal management of risks with individual design of protection leading to better planning.

3) Will Safety Net Be Risk Management Based or Income Support?

- Definition of Terms – Is risk management something the producer pays for, while income support is free? Average Crop Revenue Election (ACRE) program is income support.
- Better Contrast – Risk management that the farmer must pay for (skin in the game) and is designed around the risks the farm faces versus traditional price and income support programs?

4) Should The Safety Net Be Incentivized?

- Incentivized program means improved sales, service, discipline, with built-in barriers to waste, fraud and abuse
- Economic incentive for delivery in all states
- Is privatization a necessary condition for incentives to exist? Can a government delivered program have an incentive program?

5) Area Plans Versus Individual Coverage?

- “Our famous article” (AJAE 2012)
- Free Area Plan supplemented by buy-up with a little or no subsidy
 - Appealing to some economists as best form of federal assistance-- “catastrophic” protection that offsets systemic risk
 - Rebuttal
 - Should address theory and operational issues
 - Will work very differently in different regions, for different crops. May not work at all in some areas.

6) Is Current Subsidy Structure Optimal?

- Objection to current structure or cost?
Arguments regarding funding levels, more than structure
 - Political desire for high participation and coverage, and low waste, fraud and abuse
 - “Optimal” way to determine A&O payments are still in discovery

7) What Is The Optimal Risk Sharing Role Among Farmers, Carriers, and Government?

Still evolving. At issue: How to serve needs of producers with fewer government resources in the future

- Farmers may have to take on more risk (pay more)
- AIPs may have to take on more responsibility (more underwriting and product improvement, loss adjustment decision making, rate setting, etc.)
- RMA may face budgetary pressure and become more of a regulator

8) How Much Is Society Able And Willing To Spend?

Big Picture – Society is not spending much now. The bigger the benefits the more the public is willing to spend.

- Federal Government Expenditure – Total About \$3.8 trillion a year
- Consumer Expenditure – About \$1.2 trillion on food at home and away from home (excluding alcoholic beverages)
- CBO February 2013 baseline for safety net (crop insurance and commodity programs) averaged over 2014-2023
 - \$8.5 billion for crop insurance and \$6.8 billion for farm programs--a total of \$15.3 billion
 - Less than ½ of 1% of federal spending and 1.3% of food spending – well below a premium rate on an insurance policy
- Percentages are the incorrect way for economists to justify willingness to spend. Key is can the money be better spent--what are the opportunity costs?

9) Distortionary Effects? Land Use/Production Effects

- Literature indicates farm programs in the past decade or two have had positive but not very large effects on production and trade.
- Why would we think a program where farmers pay part of the cost, may not get a payment, have a deductible that averages 20-25% be a big problem for expansion?
- Acreage planted to primary crops: 325 million acres in 2012 versus 328 million acres averaged over 1981-2012. Literature indicates prices are primary cause of area changes.

10) Are There “Public Good Benefits” Associated With a Publicly Funded Safety Net, Both in Terms of Financial Health for the Sector and the Supply Chain?

Changing risk environment for agriculture

- Risk has been increasing and that is likely to be a key feature of the future:
 - Increasing prices (raises liability)
 - Low stocks
 - Increasing farm production costs (raises risk if prices collapse)
 - More volatile markets
 - Climate change and weather volatility
- Is the value of a safety net increasing as the market evolves to this new structure?

Summary and Conclusions

- The Farm Bill – “Déjà Vu – All Over Again...”
- Producer Subsidy
- AGI / Means Testing
- Conservation Compliance
- Title 1/Shallow Loss



A World Of Information

National Crop Insurance Services
