

American Farm Bureau Federation

Systemic Risk Reduction Program (SRRP)

Many of the proposals for policy reform as part of the overall deficit reduction effort have focused on the re-direction of direct payment monies toward a 'shallow loss' program. In their various forms, these proposals would provide government support after the producer faced some initial loss of as little as 5 to 10 percent of expected revenue. In many cases this loss would need to be in conjunction with some larger area loss in revenue which helps preclude some of the moral hazard risk associated with only an individual trigger. This 'shallow loss' protection would only cover a relatively small portion of a producer's potential loss – about 15 to 20 percent – leaving crop insurance as the real down-side protection mechanism for the farmer should a major problem occur.

While this concept is very similar to that utilized in the current Average Crop Revenue Election (ACRE) approach, it does represent a radical shift in the structure of government support. Traditionally government support was intended to provide a safety-net to help producers deal with the effects of large systemic risks and not with the smaller fluctuations in income that can come about in what could usually be called 'average' weather/market events.

Another approach to the safety net concept is to provide producers with more protection from larger down-side risks while allowing them to deal with the upper end of the risk profile on their own.

This idea would provide producers with area coverage – similar, but not identical to – the Group Risk Income Protection (GRIP) policies offered today, but at a minimal charge to the producer. These coverage levels could be relatively high, in the range of 70 percent to 80 percent, with the exact level of coverage determined by budgetary concerns. The 90 percent coverage levels referenced in the charts below are meant to be illustrative as to changes in average payments across a wide range. Where data is available, county level yield data would be used for the area trigger, but where data is limited, a crop reporting district or other geographical region could be used. One of the major differences between current GRIP policies and this core protection concept is that the price used to determine trigger levels would be based on a three year average, or a 5-year Olympic average, again the choice will depend on budget score. This approach would ensure that the program is consistent with WTO guidelines on revenue insurance programs.

In order to provide the producer with individual loss coverage, legislative changes would be needed to allow producers the ability to purchase an individual crop insurance policy that would 'wrap' this core policy. In this manner, producers would have the ability to develop individual risk protection fitting their particular needs using existing crop insurance products. In order to ensure there was no double payment for a particular loss, the area coverage would pay out first and the individual coverage second. Using this wrap approach, individual policies would be re-rated from the current structure, recognizing the risk that would be covered by the core policy. Producer premium subsidies would be provided for these wrap policies if the budget allowed. If an individual producer wished to buy coverage above this

GRIP-like policy level, these buy-up policies would be provided through regular insurance program channels.

This program would replace the current direct payment, ACRE and counter-cyclical programs, but would retain the marketing loan. Given the core program, catastrophic (CAT) coverage under the current crop insurance program, which is currently offered for a small administrative fee, would be eliminated for all covered crops. Planted acreage would be used throughout. While this program would initially be applied to program crops, all crops currently covered by RMA sponsored crop insurance programs could potentially be supported under this design, though for some crops/locations additional data may need to be developed. Considering that the core program offered here is essentially an insurance design and that it is intended to articulate smoothly with individual crop insurance products, it would make sense for the program to be delivered through USDA Risk Management Agency (RMA) just like the current federal crop insurance program.

While the core program outlined here appears markedly different from most alternatives currently under discussion, it is in fact much more consistent with the long-standing, widely-supported goals of farm policy than any of them. It is, in short, a true income safety net, designed to help farmers survive major loss events. As a true safety-net, this program would not interfere with farmers' current strong incentive and flexibility to base production decisions on market signals rather than program guarantees. Moreover, it would enhance the effectiveness of the public/private partnership that is the federal crop insurance program by allowing each party to focus on its major strength: the public sector's ability to deal with deep, systemic losses and the private sector's ability to deliver effective individual coverage based on specific farm-level needs. Finally, it would serve the broader public interest in farm policy – encouraging adequate investment in the agriculture sector by mitigating the worst of that sector's systemic risk.

As examples, six farming operations for various areas and crops were examined assuming this kind of policy approach. These were generated utilizing stochastic simulations of yields and prices similar to several other analysis efforts. Average payments under this policy option will be used to compare and contrast the potential range of support levels. These averages are just that, the average level of indemnity provided to producers under a set of several thousand possible future paths for yields and prices. Understand that in those averages are several observations where there is no payment made to producers. Later in this paper the frequency of making a payment is discussed, but again, this is essentially an insurance type program. It only makes payments when the revenue triggers are tripped.

First consider the core portion of the program. This would be the real safety net for producers, in place to provide disaster assistance without the need for annual, ad hoc, congressional action for those large scale losses usually associated with wide-spread droughts, or given the revenue nature of the product with substantial declines in market prices. Recognize that this is only the core level of support that would be provided to all producers on their planted acreage for which they would pay some minimal administrative fee. This is not the sum total of the overall package, just what is associated with the core policy.

Average GRIP Indemnity Payment Per Acre - Selected Farms/Coverage Levels						
	Illinois		Iowa		Minnesota	
	Corn	Soybeans	Corn	Soybeans	Soybeans	Wheat
90% GRIP Indemnity/ac.	\$ 203.47	\$ 45.55	\$ 113.52	\$ 60.73	\$ 45.25	\$ 34.41
80% GRIP Indemnity/ac.	\$ 127.18	\$ 20.97	\$ 58.10	\$ 31.08	\$ 25.37	\$ 17.44
70% GRIP Indemnity/ac.	\$ 71.98	\$ 7.80	\$ 25.11	\$ 13.32	\$ 12.39	\$ 7.11
	Texas		Georgia		Mississippi	
	Sorghum	Cotton	Corn	Cotton	Soybeans	Cotton
90% GRIP Indemnity/ac.	\$ 52.32	\$ 85.63	\$ 76.28	\$ 93.81	\$ 80.85	\$ 100.12
80% GRIP Indemnity/ac.	\$ 37.30	\$ 52.01	\$ 44.72	\$ 52.64	\$ 52.80	\$ 56.32
70% GRIP Indemnity/ac.	\$ 24.89	\$ 27.74	\$ 22.89	\$ 25.36	\$ 31.13	\$ 27.57

Consider the way the average payments change at the different coverage levels. The change in support from the 80 to 90 percent coverage levels is noticeably larger than the change from 70 to 80 percent. Again, this coverage level will be determined by budgetary considerations, but there should be room to provide coverage in this range and still meet the expected targets.

Notice also the differences between say corn and soybeans in Illinois and Iowa. The reasons for the difference are due to a number of factors, but the major cause is the fact that soybean revenue tends to be less variable than what is associated with corn and thus the lower expected payouts. Similarly notice the difference in expected payouts for soybeans between Mississippi and Illinois. Here the difference is caused by the higher degree of variability in soybean yields in Mississippi than in Illinois, generating a higher frequency of payout than what is expected in Illinois, particularly at some of the higher loss levels.

The next layer of protection is provided by the individual producer coverage added to – or wrapped – around this core package. In order to provide some clarity to the example a core level of 80 percent is assumed. Be clear that the exact level of core coverage will be set by budgetary considerations.

Individual Indemnity With & Without 80% GRIP						
	Illinois Corn			Minnesota Wheat		
	No Wrap	With 80% Wrap	Difference	No Wrap	With 80% Wrap	Difference
85% Coverage	\$ 98.36	\$ 79.04	\$ (19.32)	\$ 54.39	\$ 48.91	\$ (5.48)
75% Coverage	\$ 48.84	\$ 40.26	\$ (8.58)	\$ 39.21	\$ 35.02	\$ (4.19)
65% Coverage	\$ 19.99	\$ 16.96	\$ (3.02)	\$ 27.10	\$ 23.98	\$ (3.12)
	Texas Cotton			Mississippi Soybeans		
	No Wrap	With 80% Wrap	Difference	No Wrap	With 80% Wrap	Difference
85% Coverage	\$ 76.07	\$ 58.16	\$ (17.91)	\$ 67.59	\$ 49.91	\$ (17.68)
75% Coverage	\$ 51.41	\$ 38.58	\$ (12.82)	\$ 47.55	\$ 34.52	\$ (13.03)
65% Coverage	\$ 32.93	\$ 24.29	\$ (8.64)	\$ 31.61	\$ 22.61	\$ (9.00)

To make the table clear, the indemnity represents the average annual payout for the coverage selected. It does not reflect any producer premium subsidies that might be provided. But on average the Illinois corn producer at the 85% coverage level would expect to receive \$98.36 per acre from this policy without the core policy in place. With the core policy in place the same producer would expect to receive \$79.04 from this policy, in addition to the \$127.18 she would expect to receive on average from the core policy. Notice that the indemnity – and thus the cost - of the individual policy drops by \$19.32 per acre with the core plan in place. Notice further that the degree to which the indemnity expectation falls with core in place declines as the producer selects lower coverage levels. This is due in part to the fact that there is less risk being protected, as well as the fact that the expected indemnity is that much smaller as well. This change though is consistent throughout the various policies with the 85% coverage seeing roughly a 30-35 percent reduction in indemnity costs while at the 65 percent coverage level the proportional reduction is closer to the 15-25 percent range.

The package is the combination of these two programs and the expected indemnity they would provide together. Again, the final level of core coverage will be determined by the budgetary factors. Both the 90 and 70 percent core level examples are provided, recognizing they represent the likely bounds.

Average GRIP+Individual Indemnity Payment Per Acre - Selected Farms/90% GRIP						
	Illinois		Iowa		Minnesota	
	Corn	Soybeans	Corn	Soybeans	Soybeans	Wheat
85% Coverage	\$ 275.56	\$ 69.07	\$ 160.14	\$ 70.15	\$ 83.16	\$ 79.07
75% Coverage	\$ 240.58	\$ 54.63	\$ 136.86	\$ 63.02	\$ 70.93	\$ 66.21
65% Coverage	\$ 219.30	\$ 48.12	\$ 123.74	\$ 61.05	\$ 61.74	\$ 56.07
	Texas		Georgia		Mississippi	
	Sorghum	Cotton	Corn	Cotton	Soybeans	Cotton
85% Coverage	\$ 82.34	\$ 136.74	\$ 125.18	\$ 150.99	\$ 125.23	\$ 171.13
75% Coverage	\$ 73.65	\$ 119.38	\$ 107.59	\$ 125.36	\$ 111.47	\$ 146.29
65% Coverage	\$ 66.75	\$ 106.77	\$ 94.92	\$ 94.92	\$ 100.85	\$ 128.05

Average GRIP+Individual Indemnity Payment Per Acre - Selected Farms/70% GRIP						
	Illinois		Iowa		Minnesota	
	Corn	Soybeans	Corn	Soybeans	Soybeans	Wheat
85% Coverage	\$ 154.83	\$ 37.94	\$ 97.01	\$ 30.50	\$ 56.69	\$ 58.49
75% Coverage	\$ 114.93	\$ 20.40	\$ 65.98	\$ 19.31	\$ 42.88	\$ 44.39
65% Coverage	\$ 89.90	\$ 11.48	\$ 44.63	\$ 14.49	\$ 31.95	\$ 32.77
	Texas		Georgia		Mississippi	
	Sorghum	Cotton	Corn	Cotton	Soybeans	Cotton
85% Coverage	\$ 60.52	\$ 90.93	\$ 85.14	\$ 103.60	\$ 85.24	\$ 115.70
75% Coverage	\$ 50.78	\$ 70.80	\$ 64.52	\$ 72.11	\$ 69.49	\$ 87.03
65% Coverage	\$ 42.59	\$ 54.96	\$ 48.33	\$ 49.18	\$ 56.35	\$ 64.02

These are average levels and it is important to understand that there will be several years where the program would not provide any payments. It is after all, an insurance program and should only pay out when conditions warrant. Obviously at lower coverage levels, the frequency of a payout declines. At the 90 percent coverage levels, producers would expect a core-based payment in roughly 40 percent of the time while at the 70 percent level payouts expectations would be as little as one or two years out of ten.

Frequency of Payout - GRIP Coverage Only						
	Illinois		Iowa		Minnesota	
	Corn	Soybeans	Corn	Soybeans	Soybeans	Wheat
90% GRIP	46%	31%	35%	37%	38%	36%
80% GRIP	34%	11%	22%	24%	26%	23%
70% GRIP	23%	9%	12%	13%	16%	13%
	Texas		Georgia		Mississippi	
	Sorghum	Cotton	Corn	Cotton	Soybeans	Cotton
90% GRIP	46%	42%	41%	42%	44%	39%
80% GRIP	38%	31%	29%	31%	35%	27%
70% GRIP	31%	21%	19%	21%	25%	16%