Agricultural insurance: what role for the CAP?

"EAAE seminar on Prospects for Agricultural Insurance in Europe"

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Outline of issues covered

1. Types of risks inducing volatility

2. CAP measures to address risks from volatility

3. Update of risk-relevant analyses
What types of risks to address?

**Price-related risks**
- Uncertainty about the level of future prices
- Excessive price volatility
- Co-movement of commodity prices

**Production risks**
- Production risks linked to catastrophic events (drought, flooding, wildlife, etc...)
- Plant and animal diseases
- Increased production insecurity due to climate change

**Income-related risks**
- Increased income variability
- Farm cash-flow constraints
- Farm income squeeze due to costs or bottlenecks in the food chain
How to address price risks?

**Price Support via market intervention**
- Provides a guaranteed, predefined price-floor
  - Price determines trigger at which products are withdrawn from the market
  - Public storage with public cost (including future release in the market)
  - Private storage with private responsibility (could include public support)

**Futures markets**
- Provides the possibility to transfer price risk (hedging)
  - Facilitates price discovery
  - Often provides benchmark price used by cash market and in forward contracting
  - Serves as asset class to diversify investment or speculative portfolios

**Contractualisation**
- Mitigates price risk (fixed reference for specific time-period)
  - Provides fixed price environment
  - Requires production stability of both quantity and quality
  - Facilitates collective bargaining
How to address production risks?

**Insurance schemes (ex-ante)**
- Mostly covering weather-related risks
  - Offered by private insurance companies
  - Public support in the cost of premiums often used to encourage farmer uptake
  - Administrative capacity necessary for accurately estimating losses

**Mutual funds (mostly relevant in the livestock sector) (ex-post)**
- For affiliated farmers, compensation paid for economic losses
  - Losses caused by animal plant diseases/outbreaks, adverse weather events
  - Public support (partly) for the setting up of the fund and compensation paid out
  - Requires long-term public budgetary planning and private contributions

**Natural disaster aid (ex-post)**
- Mitigates production losses
  - Effects are very regional in nature and asymmetric in impact
  - Hard to foresee, such events stress budgetary resources
  - Occasionally, such events could have longer-lasting impacts
How to address income risks?

Direct income support - **decoupled**
- Provides a *fixed* annual income buffer, independent of production decisions
  - Requires market-orientation and a level of risk-taking by producers
  - Is linked to conditionality of minimal public-good delivery (cross-compliance)
  - Receives often criticism on distribution of benefits (including of land and timeliness)

Direct income support - **coupled**
- Provides a *variable* annual income, dependent on sector-specific production decisions
  - Provides a necessary income layer for extensive livestock in marginal areas
  - Reflects concerns for other, sector-specific production maintenance
  - Could distort competition with other products which could have production potential

Counter-cyclical / income stabilising support schemes
- Cover *difference* between prices, revenues or margins from a corresponding reference level
  - Could be either product- or farm-specific
  - Vary significantly annually, depending on price level
  - Are often based on regionally adjusted reference levels (exception: US milk margin)
What choice for the CAP on price risk?

The CAP reform process has opted for gradual market orientation

- **CAP choice of measures towards more exposure of farmers to world price fluctuations**
  - *Price gap* between EU and world market prices was either closed or reduced
  - *Agro-food trade* turned positive with value-added production main beneficiary
  - *Income* became more volatile, but reversed previous negative trend

Price safety net is still available – but at lower price levels

- **Public intervention, and exceptional measures, still very much operational**
  - Public intervention has had very limited use, except during the two dairy crises
  - Private storage removed some pressure from the market in cyclical price downturns
  - Yet existing measures have limited scope in improvement of their efficiency

Price volatility remains inherent in agricultural production

- **Policy question: Is there a different policy mix desirable and feasible?**
Dairy price challenges

EU and world dairy prices

C/100 kg

Source: DG Agriculture and Rural Development calculations
What choice for the CAP on production risk?

Ex-ante + and ex-post risk management

- Measures exist in both Pillars of the CAP
  - In sector-specific operational programmes (fruits & vegetables; wine) – Pillar I
  - In insurance schemes and mutual funds in Rural Development programmes 2014-20
    - 12 RDP’s (10 MS) supporting insurance premiums (2.2 billion €)
    - 3 RDP’s mutual funds (357 mio € economic compensation for animal/plant diseases)

Natural disaster aid (ex-post)

- Compensation is based on both EU and MS funding
  - Implemented by MS, mainly through state aids
  - Address mainly regionally specific risks
  - RD preventive measures are available (limited to investment aids)

Production risks increase output, and thus income volatility

- Policy question: Why is the uptake of production-reducing risk schemes limited?
What choice for the CAP on income risk?

The CAP has chosen to directly support farm income
- At EU-level via common policy measures
  - Via area-based decoupled income support for more than 90% of direct payments
  - Via limited voluntary coupled support in sectors presenting production risks
  - Via additional targeted aid during crises (Russian ban, dairy and livestock sectors)

RD measures have expanded the possibility of income support
- At MS-level via new or enhanced instruments in RD
  - Income Stabilisation Tool included in Rural Development Programmes for 2014-2020
  - Limited uptake - 3 IST's (Italy, Hungary, Castilla y Leon) totalling €130 million
  - Questions have been raised about the conditionality of the measure

Income volatility is expected to continue, or even increase in the future
- Policy question: Why is the uptake of different income support schemes limited?
What reasons explain limited uptake in RD?

WTO Green Box requirements

- Targeting of specific sectors is not possible
- Income trigger of a minimum loss of 30% has to be respected
- Need to calculate income losses at individual farm level (use of indices not allowed)

Budget unpredictability

- Annual structure of budget rules excludes such schemes from Pillar I
- Significant amounts of funds need to be blocked with uncertainty on their use
- Despite caveats, direct support presents more certainty, thus limiting scope in RD

Definition of income in Basic Act

- Income is defined as total revenues + public subsidies – input costs
- High reliance of some sectors on total public support (e.g. livestock, dairy)
- Thus, even in severe market crises, the trigger would not easily be activated
The role of subsidies in EU farm income by sector

Proportion of subsidies (excluding on investments) to farm income (FNVA) by type of farming (cum. 2007-2013)
Updated analysis of 2014 IA based on more recent data

Implementing a compulsory Income Stabilisation Tool at EU level

Basic elements:

• Providing financial compensation to all participating farmers for a "severe drop in income"

• Income losses defined as a drop of income
  • exceeding 15% or 30% of average income of the individual farmer in the preceding 3-year period

• Compensation would represent 65% of the farmers income loss
  • (income = sum of market revenues + public subsidies – input costs)
Where does income decrease by more than 30%?

In approx. 30% of EU farms (min 21% - max 43% per year)

Main impact:

- the smaller economic size classes

- most affected sectors in %: COP crops, granivores, horticulture (less affected: milk)

- Member State distribution implies that 2/3 of total farms concerned operate
  - IT, PL, ES, EL
  - This is in line with the corresponding relevant economic size, number of farms, type of farming, etc.
Share of farms with income losses exceeding 30% - by size

Share of farms where farm income (FNVA) losses exceed 30% by economic size class, avg 2007-2013

* The first two classes do not include all EU25 MS (cf. FADN min. thresholds)
### Share of farms where farm income (FNVA) losses exceed 30% by type of farming, avg 2007-2013

<table>
<thead>
<tr>
<th>Farm Type</th>
<th>Share of Farms exceeding 30%</th>
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<tbody>
<tr>
<td>Milk</td>
<td>22%</td>
</tr>
<tr>
<td>Mixed livestock</td>
<td>26%</td>
</tr>
<tr>
<td>Sheep and goats</td>
<td>27%</td>
</tr>
<tr>
<td>Mixed crops and livestock</td>
<td>28%</td>
</tr>
<tr>
<td>Other fieldcrops</td>
<td>28%</td>
</tr>
<tr>
<td>Wine</td>
<td>28%</td>
</tr>
<tr>
<td>Olives</td>
<td>30%</td>
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<tr>
<td>Fruit</td>
<td>31%</td>
</tr>
<tr>
<td>Cattle</td>
<td>32%</td>
</tr>
<tr>
<td>Horticulture</td>
<td>32%</td>
</tr>
<tr>
<td>Mixed crops</td>
<td>32%</td>
</tr>
<tr>
<td>Granivores</td>
<td>34%</td>
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<tr>
<td>Cereals-Oil seeds-Protein</td>
<td>34%</td>
</tr>
<tr>
<td>Permanant crops combined</td>
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</tbody>
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**Share of farms with income losses exceeding 30%** by type
Share of farms with income losses exceeding 30% - by MS

Number and % of farms where farm income (FNVA) losses exceed 30% per MS, avg 2007-2013
The US dairy margin protection programme – any lessons?

- **Main principle:** protect against a drop in US dairy margin

- **Which margin?**
  - US all milk price minus average US feed ration
  - Calculated at federal level, every 2 months
  - Feed ration = 56.4% maize, 15.2% soymeal, 28.4% alfalfa hay

- **Which production?**
  - Historic production = highest annual milk production marketed during 2011-2013 period
  - Adjusted every year to reflect the increase in US production
  - Adjustment factor applied in 2015 = +0.87%
  - Seasonality not accounted for, compensation for 2 months = annual historic production / 6

- **Which margin coverage?**
  - Minimum = 4 USD/cwt * 90% of production, no premium fee (but 100 USD admin. fee)
  - Up to 8 USD/cwt for 25% up to 90% of production, with farmer premium of 0.01 to 1.36 USD/cwt
A US-type indicator reflects US farm reality

Why?

• The US indicator accounts for hay (up to 28% of the ration), whose price varies much less than maize and soymeal prices
• EU farmers sell milk at current (monthly) market price, buy feed when prices are low, don't use futures
• When feed prices are high, farmers adapt rations to reduce costs (farmers have ways to adapt!)
• Purchased feed weighs less in EU systems than in the US
Share of purchased feed in operating costs by MS

Source: FADN and ERS USDA, 2013 data
Conclusions on IST

Caveats of an EU-wide Income Stabilisation Tool

- Too big administrative burden, huge technical difficulties to implement at EU level
- A system of monitoring individual farm income developments would be needed
- It implies important redistribution of support, in favour of only a few Member States

The update of analysis confirms previous conclusions

- Smaller economic sizes report higher income losses (but also depend more on DP)
- Higher income volatility does not necessarily affect sectors with high income pressure
- Very significant differences exists among MS, reflecting their different structures

To increase the actual uptake by MS for ISTs, what is needed is

- To explore the possibility and feasibility for sector-specific IST
- Assess the potential impact of lowering the income loss trigger
- Explore the requirements to introduce and use of indices
Reports and data available at:

http://ec.europa.eu/agriculture/index_en.htm


Thank you for your attention!