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Do Administrative Costs Count in The Farm Bill?¹

Press reports are suggesting a Farm Bill will have multiple commodity program options. This will increase the administrative cost for implementation of a commodity program. Given the size of the proposed cuts in commodity programs, a complicated program with "large" administrative costs may (will?) approach the point where administrative costs exceed the benefit to farmers. Farm level loss adjustments and multiple program options, etc. will add to the administrative cost of the Commodity Title.

All of the proposed commodity programs (except for direct payments) are derivatives of crop insurance and Board traded options. The difference is farmers pay no premium costs and as a result will always want the highest coverage possible. Changing the yield trigger in ARRM from district to a county yield trigger will increase the need for strong underwriting. A county-level ARRM program would require identification of practice at the farm level (nonirrigated or irrigated) and in some cases may need a summer fallow practice. However, separating crops by practice will have a tradeoff with administrative costs. The program will also need a payment factor (insurance term is co-pay or quota share) and no disappearing deductible. If one were to pay 100% of the calculated county loss with a disappearing deductible, then farmers would not need to "conspire at the coffee shop" to collect payments--it will simply pay to plant dryland corn in a large number of high risk counties. One would also expect more continuous cropping in summer fallow regions. If these underwriting rules were included then the county

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triggered area plan could work as nearly as well as a district trigger, but a county trigger would absolutely need a “significant” payment factor to prevent high levels of moral hazard and adverse selection.

A commodity program with loss adjustment at the farm level would simply replace crop insurance with no farmer paid premium. It would make more sense to address some of the limitations in crop insurance. The major “hole” in crop insurance is the declining APH yields caused by multiple year losses. Many growers in the Southern Plains are paying for 75%-80% coverage but because of the declining APH, their effective coverage is about 65%-70%.

Why are many of these same features built into crop insurance? How does crop insurance underwrite these risks? The answer is simple, higher coverage levels and better coverage will have larger premium costs. Under a “free” Commodity Title program there is simply no incentive to self insure any of the risk, as clearly is the case for crop insurance. Therefore, it will be necessary for policy makers to set the coverage levels, stop loss, payment factor, and eliminate a disappearing deductible.

Below is a comparison of a “low” risk Iowa corn county and a “high” risk Kansas sorghum county. The low risk county would prefer a low deductible. Cutting the payment trigger from 90% to 85% with no stop loss would cut the payments in the low risk county by about 37% but only 17% in the high risk county. If the coverage were 90% but a stop loss was added at 70%, that would cut the expected payments in the high risk county by 27%, but expected payments in the low risk county would be cut by 43%! Increasing the stop loss from 70% to 75% would cut the expected payments in the low risk county by 13% versus 22% in the high risk county (see table 1 below).

Table 1. Reductions in Expected Payments Based on % Triggers

The Impact on Payments for County Triggered "ARRM" with Different % Trigger and % Stop Loss for Low Risk Iowa Corn Vs. High Risk Kansas Grain Sorghum*		
	Low Risk	High Risk
Cut payment trigger from 90% to 85% & no stop loss	37%	17%
Add a 70% stop loss with a 90% payment trigger	27%	43%
Increase the stop loss from 70% to 75%	13%	22%
*Expected payments are based on RMA rating methods		

The reason for this is obvious; the low risk counties have most of their yield risk in the top 1/3 of the yield distribution, while the high risk counties have a significant amount of yield risk in the bottom 2/3 of their yield distribution. Simply put, it would be very rare, if ever, to observe a 50% yield loss at the county level in low risk production areas. However, county level losses of 50% or more have occurred in the high risk counties.

Clearly the deductible is more important in the low risk county and the stop loss is more important in the high risk county. Obviously these are two extremes and most growers results will be in the middle. In any case, if the policy makers could agree on the deductible and the stop loss, then the payment factor could be used to make the program fit the targeted budget.

The area based plan, with the exception of Direct Payments, would generate the least administrative cost for the commodity programs. Because yield data are available for an area plan (and in many cases for a county based plan), payments would be easily calculated. The Farm Service Agency (FSA) could also utilize farmer reported yields to the Risk Management Agency (RMA) to determine county level yields, in addition to the limited National Agricultural Statistical Service (NASS) estimated county yields. Most reasonable people would agree that crop yields reported under criminal liability for false reporting are at least as creditable as survey data.

Administrative cost may not be borne by taxpayers. If the result of the Farm Bill is a more complicated program, then the cost will be borne by farmers if FSA is given no additional funds to cover administrative costs. The cost will come from the amount of time county FSA employees will have to explain and administer the new program(s) to growers. Likely it will be necessary for farmers to make appointments and there is a cost to growers for their wait time.