Canadian BRM Programs Revisited

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Salient facts about BRM intervention

- The BRM policy is a major effort contributing to reducing risk and stabilizing farm income In Canada.
  - Safety nets redistribute income (cut off bottom of cycle not top and premiums are not actuarially sound)
- Policy tool kit includes BRM Suite (AgriInvest, AgriStability, AgriInsurance & AgriRecovery), cash advances, & ad hoc programs
- Evolution of BRM policy has been driven by a number of pressures and constraints:
  - Concerns about government deficits and debt;
  - The pressures of international trade agreements;
  - A desire not to mask the market signals or affect production decisions

Economic principles vs. industry wishes

OECD (2011) Principles

- Do not blunt market signals
- Different layers of risk require different responses
- Effective policy pays attention to interactions and trade-offs among
  - Policies & risk management practices
  - Different policies

Industry Demands

- Want funds to producers that are timely, predictable, bankable and straight forward
- Restore 85% trigger
- Roll over unused funding
- Young farmer programs
  - Waive premium 1st 5 years
  - Make extra AgriInvest contributions
- Encourage participation

Risk management

Tends more to income transfer than stability

Are they compatible?

Preserving market signals

- The BRM programs may encourage excess production and distort trade flows
- Can also affect the entry and exit decisions
- Rewards losses from poor management practices
- In addition, programs
  - Reduce the variance of returns
  - Increase expected returns (wealth effect)
  - Together this creates an incentive to grow riskier crops
  - Portfolio hypothesis gives some explanations: BRM policy likely to encourage farmers to take on more risks in other parts of portfolio to maintain the most efficient portfolio strategy (Gabriel and Baker 1980) & (Uzea et al. 2014)

Interactions with other risk management practices

- How does *AgriStability* affect relevant decisions?
  - Limit the incentives for using on-farm strategies and market risk-management tools
    - Discourage diversification as a tool to mitigate risk
    - Reduce private risk sharing – vertical coordination, marketing contracts
- Off-farm labor as risk mitigation strategy which is ignored
- Policies should avoid crowding out the adoption of individual risk mitigation practices and the development of private markets for risk management

Pay attention to different layers of risk

- Risk can be categorized into:
  - everyday (normal) risks
  - marketable risks (contingent markets)
    - ✓ futures, marketing contracts
  - catastrophic risks

Boundaries should be determined with careful analysis and evidence-based, not by political expedience

- For “normal” risks
  - should leave the responsibility to the farmers and need no policy intervention
- Don’t want multiple coverage for each level of risk
  - Not only complicated (creating off-sets), but also inefficient
  - Why wouldn’t each risk layer have a different premium
- Bottom line there is nothing magical about 85%

Individualized net whole farm margin

- They delay and uncertainty of *AgriStability* payments
  - slows payouts, reduces predictability and adds extra accounting costs
- Use of tax filer $\Rightarrow$ accrual basis results in:
  - Slows process; uncertain outcomes; increased accounting cost
- Potential remedies to speed up the process & predictability
  - Move away from whole farm net income to crop specific prices or revenues. **But** this blunts market signals
  - Use regional net returns as the trigger… lose targeting ability
  - Preliminary and final payments…even more complex
- By its nature, programs coupled with market risk or uncertainty cannot be predictable

Measuring Performance

- Do BRM programs reduce short term income variability?
  - Simulation exercises indicate a 20-30% reduction
  - OECD (2011) estimates with farm-level data indicate a 20% reduction
    - -0.3 correlation coefficient between margin and program payment
- In a timely manner?
  - Vercammen (2013) short term versus long term

    On a $1 loss recovery is 27¢ short run and 84¢ cumulatively in the long run
- Participation rate
  - Not necessarily a good criterion … increasing participation rate doesn't mean that it is a good risk management tool.

Income Support

- If risk reduction is the primary objective

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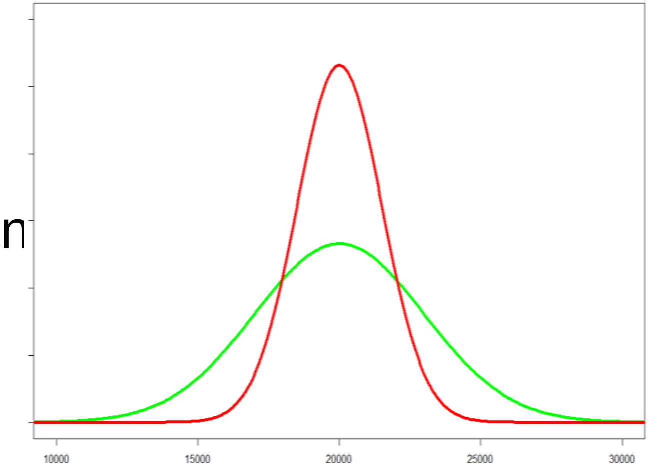

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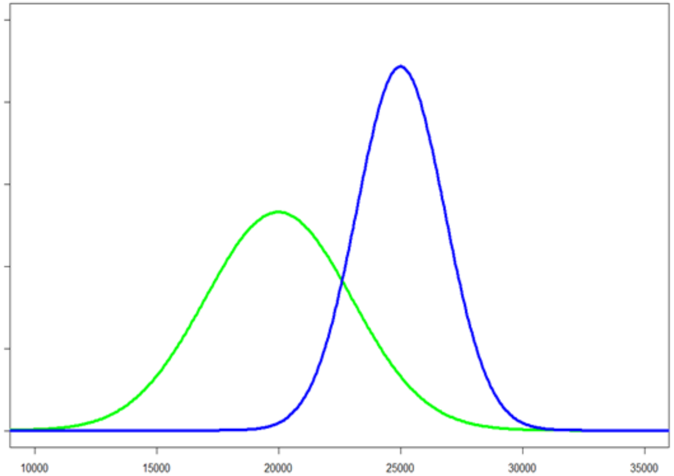

- One instrument can’t achieve both objectives efficiently (Tinbergen’s Rule)

Income Support

- If income support is the primary objective
  - Most effective method is a direct/decoupled payment
    - Transfer efficiency is higher
    - Less distortion to markets
  - *AgriInvest* is income support in nature, better not be viewed as a risk management tool

Tips for Effective Policy

- The objectives for providing government supported BRM programs need to be clear
  - Direct payments more consistent with income transfers though have little to do with risk management…and don't expect targeting
- Attention to timing of payouts but difficult to address due to the targeting design
  - Trade-off between individualized margin and timeliness of payment
- Effective BRM programs require better understanding of different layers of risks
  - Leave the responsibility of "normal risks" to the farmers
- Off-farm income/labor supply deserves some attention
  - Smooth and increase total net income