National Farmers Union recommendations regarding Business Risk Management Programs under Growing Forward 2

August, 2012

What are the Business Risk Management Programs?

Growing Forward 2 (GF2) is the set of joint federal-provincial-territorial agriculture programs that will be put into place for 2013 to 2018, once Growing Forward 1 ends on March 31, 2013. There are two aspects to Growing Forward 2 – a set of "Strategic Initiatives" to support policy goals agreed upon in July 2011 by provincial, territorial and federal ministers as outlined in the *Saint Andrews Statement* and the "Business Risk Management" (BRM) programs. The suite of BRM programs will be delivered through a multi-lateral agreement between all the provinces, territories and the federal government. The program will be finalized in September 2012, and is currently being negotiated. The other GF2 programs will be delivered through a series of bi-lateral agreements between the federal government and each province or territory in turn. These programs will be negotiated after the BRM decisions have been made.

BRM programs are also known as "safety net" programs for agriculture. They are AgriStability, AgriInvest, AgriInsurance and AgriRecovery. There has been some discussion of introducing a new program that would provide for price insurance. Each BRM program is assigned a budget, with the exception of AgriRecovery, because it deals with disaster insurance, which is unpredictable. BRM programs are cost-shared 60:40 by the federal and provincial governments.

Why BRM programs are important to family farmers

Canadian farmers are experiencing a prolonged income crisis. Federal agriculture policy has consistently promoted increasing agri-food exports regardless of the impact on Canadian farm families, farms and food supply. Federal policy also adheres to market fundamentalism – the belief that markets will solve all problems – without recognizing the vast differences in market power between a farm family and the global corporations that supply farm inputs and purchase farm products, and the impossibility of fairness under these conditions; nor does the "market" recognize non-financial values such as culture, health, community and ecological integrity that are important to citizens. The National Farmers Union advocates for policy that would bring about ***food sovereignty***, a profoundly different approach to agriculture and food policy which would support the livelihoods of farmers, ensure adequate and wholesome food for consumers, work in cooperation with nature and include citizens in meaningful decision-making regarding the food system.

In the absence of a food sovereignty-based federal agri-food policy, we do need safety net programs to help family farmers survive the on-going crisis. The BRM suite needs to be designed in such a way that it actually protects small and medium-sized family and co-operative farms and allows them to maintain and build their farms as viable businesses that can be passed on to the next generation of farmers.

What kinds of risks do farmers face, and do these programs provide protection?
Many of the business risks that family farmers face are due to government and corporate policies that favour global agribusiness as well as large-scale food processing and agricultural input manufacturers operating in Canada –policies that increase the scale of farms, prioritize exports over domestic markets, and allow the introduction of genetically modified crops without regard for market impacts. Other risks are due to the unpredictability of international markets, currency exchange rates and external political issues that are beyond the control of our national government. And still other risks are due to the increasing volatility of our weather and changes in disease pressures and pest populations as a result of climate change, which will only worsen as a result of Canada's and other countries' unwillingness to reduce emissions and take effective action to reduce the amount of carbon dioxide in the atmosphere.

The BRM programs vary in their effectiveness to address the economic impacts of these risks. Each of these programs can be improved so that public dollars do a better job of keeping Canadian farm families on the land, producing good food for all, and contributing as citizens within their local communities.

What changes are being discussed?
The 2012 federal budget indicated there will be a 10% ($310 million) cut in the Agriculture and Agri-Food Canada's budget over the next three years with $250 million of that being cut from AAFC's core. It is expected that a significant amount of that cut will be to the federal portion of the BRM programs.

The federal budget mentioned "refocusing" the BRM programs, but did not state what specific amounts would be allocated to them.

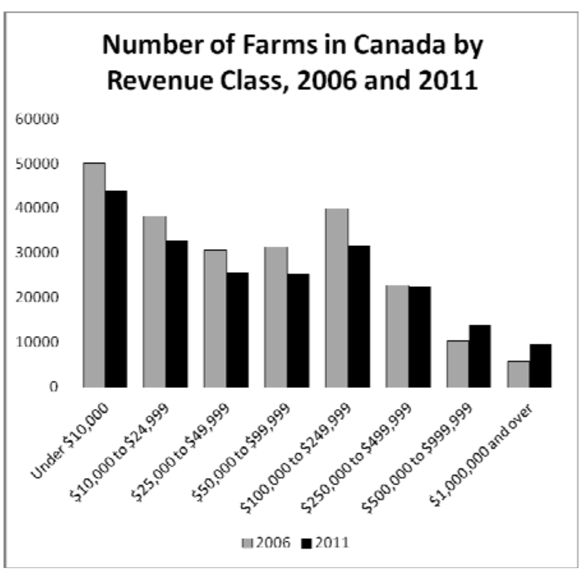
> *The coming year will see a focus on setting the right conditions for farmers and businesses in the agriculture and agri-food sector to compete and adapt. The Government will work with its provincial and territorial partners, and with industry, to develop a new federal-provincial-territorial agricultural policy framework to replace the current Growing Forward agreement in 2013. The new five-year framework agreement will set out policies and programs to support a modern, innovative and market-oriented sector. This will include a refocused suite of Business Risk Management programs.* (page 119, Federal Budget 2012)

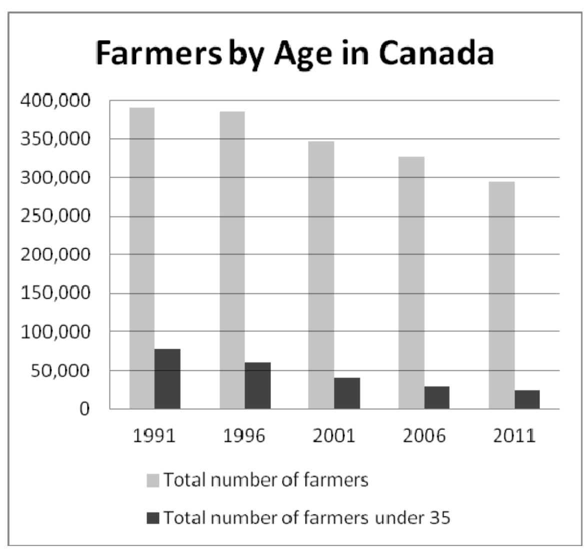
The House of Commons Standing Committee on Agriculture and Agri-Food did a study and held hearings on GF2. Its report was published in May 2012. The Conservative majority on the Committee implied that the per-farm program cap should be removed. In addition to some minor recommendations for changes to the BRM programs, it also indicated support for exploring a new price insurance program. The Opposition parties on the Committee each submitted dissenting reports. The NDP called for semi-annual performance reviews of the BRM programs so that problems can be identified and addressed quickly. The Liberal Party called for a review of the reference margin calculation used in AgriStability.

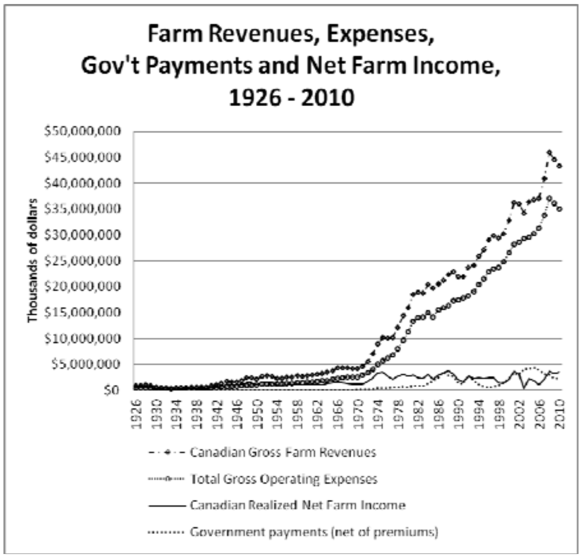
At a meeting in Ontario in July, Greg Meredith, federal assistant deputy agriculture minister in the strategic policy branch, said that the government considers existing BRM spending is “too rich, discourages farmers from assuming more of their own risk through private programs and reduces government ability to invest in innovation. The programs taken together are just too rich.” (Western Producer, July 27, 2012) He indicated that AgriStability was going to be the focus of the planned budget cuts. His statement seems to signal a desire by the federal government to promote private insurance instead of maintaining a publicly funded safety net.

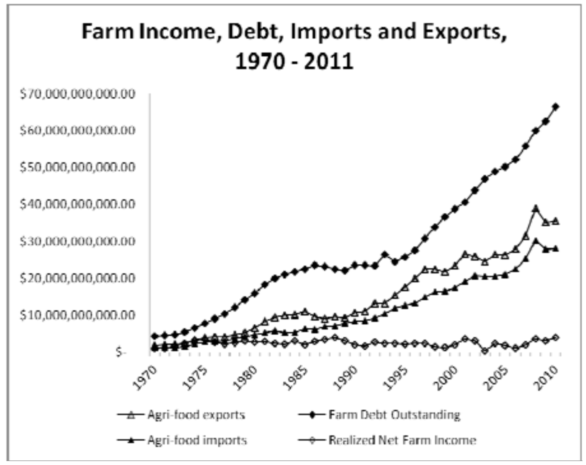
How well did Growing Forward 1 work?

We have not seen an official evaluation of GF1 and its BRM suite. The National Farmers Union has examined economic data from recent years, and we observe that long-standing trends persist in spite of the GF1 safety net programs. The 2011 Census shows us that the number of farms in Canada continues to decline, farmers are aging and fewer young people than ever are engaged in farming. Net farm income has remained near zero in spite of the increasing total value of agriculture products our farmers produce. And as exports have increased dramatically, farm debt has grown even faster. We must emphasize that in large part, the BRM programs, with the exception of AgriInsurance, are in place because of problems caused by the continued refusal of government to address the anti-competitive behavior of oligopolistic railways, grain companies, meat processors, seed companies and input suppliers. While the safety net is needed, it is not sufficient to solve the structural problems that face Canadian agriculture.









Safety Nets, Farm Income and the Market

There is a strong consensus among Members of Parliament and farmers that it is preferable for farmers to obtain an adequate income from the market so they do not have to rely on program payments. What GF2 lacks is an analysis of the kind of policy framework that would create market conditions that would support thriving family farms in Canada.

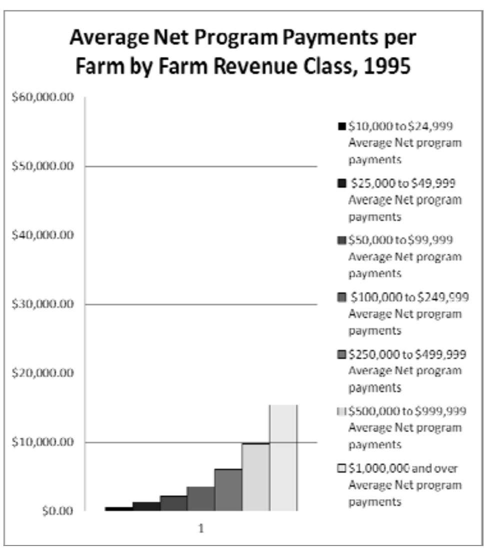
The Agriculture Committee report highlights the fact that under supply management, dairy, egg, turkey and broiler producers generally do not draw upon AgriStability. The three pillars of Supply Management – import controls, cost of production pricing for farmers, and production limits – ensure that Canadian farmers produce the majority of the dairy, eggs and poultry consumed by Canadians, they earn their living from the marketplace, and there are no shortages or surpluses to provoke price volatility. Supply management is an effective business risk reduction strategy which virtually guarantees producers in these sectors will not experience the 15% margin reductions that would trigger AgriStability.

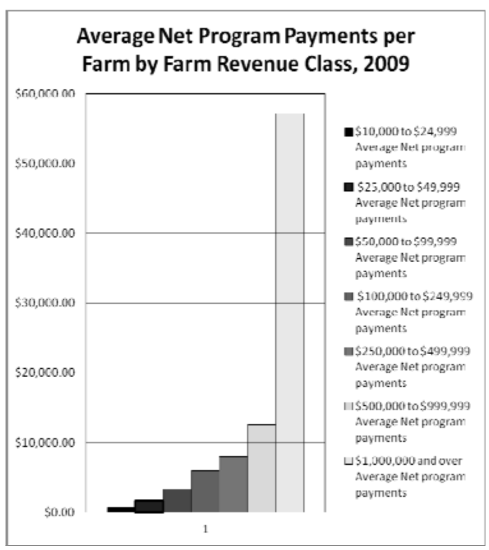
Supply management is a system that works, but it may well be threatened by export-oriented Canadian trade goals and agriculture policies. If import controls (tariffs) on supply managed commodities are given up by trade negotiators in order to enable global corporations operating in Canada to benefit from the terms of the Trans Pacific Partnership and/or the Canada-European Union Comprehensive Economic and Trade Agreement the supply management system will cease to function.

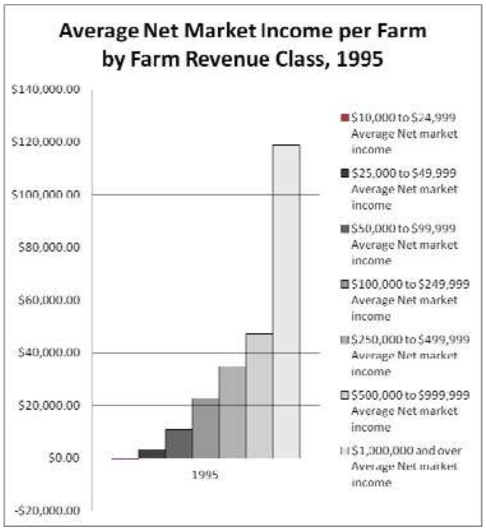
One way to reduce business risks to more Canadian farmers would be to develop policy measures that would also reduce the non-supply managed sectors' exposure to volatility in their markets. Reducing the degree of reliance on export markets would reduce exposure to currency fluctuations, as a greater proportion of sales would occur within Canada, and would be unaffected by the exchange rate of the Canadian dollar. Limiting imports of agricultural products that Canadian farmers can produce would provide predictability of demand over time, and allow farmers to make longer-term investment decisions, knowing that they will be able to sell what they produce to Canadians. By promoting import substitution, consumer dollars that leak out of our economy through purchases of imported food in the grocery stores would instead stay in Canada to support our farmers, rural communities and food processing and distribution sectors.

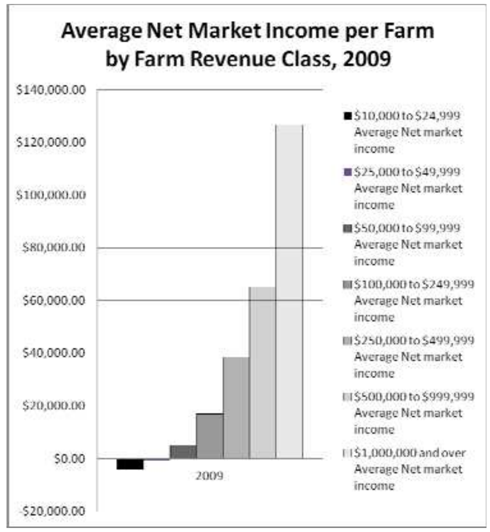
Farm Size, Program Caps and Internal Market Distortion
Currently, the biggest farms are capturing a disproportionate share of BRM payments due to the design of the programs and to the high cap ($3 million per farm) on maximum payments under AgriStability, and high cap for eligible sales under AgriInvest. A farm that is highly specialized and depends on export markets has a greater degree of margin volatility due to wild swings in world markets and currency exchange rates. These dramatic changes trigger huge farm support payments in poor years. In contrast, smaller, more diversified farms, while still being subject to other risks, including weather, are protected from the impact of price volatility in a single market, so have less likelihood of triggering a payment, and obtain smaller ultimate payments. This dynamic contributes to the concentration of ownership by favoring the larger producers and accelerates the loss of family farms.

The graphs below show that between 1995 and 2009 the largest farms dramatically increased their dependence on program payments, while during the same period they only slightly increased their net revenues from the market (note, the figures are not adjusted for inflation). If the cap is removed and the overall program funding is cut, this inequity will become even more pronounced.









- ***The National Farmers Union recommends that the maximum payment under AgriStability be reduced from the current $3 million per farm to $300,000 per farm.***

The current cap has created an incentive for highly risky operations to expand extravagantly. Not only does this result in a transfer of public dollars to imprudent private businesses, but these large entities destabilize the market for other, smaller operators by flooding the market with their subsidized product.

- ***The National Farmers Union also recommends that the program cap for AgriInvest be lowered to $1 million of eligible sales, and access to matching grants be provided on a sliding scale based on the total eligible sales per farm up to the maximum of $1 million/farm/year.***

- ***The National Farmers Union recommends that all subsidiaries of a corporate entity be considered a single farm for BRM program purposes. In other words, an agribusiness corporation could not subdivide its operations into a series of smaller spin-off companies in order to maximize its payout under GF2 BRM programs.***

AgriStability

AgriStability provides payments based on the reference margin – the average margin over the past 5 years leaving out the years with highest and lowest margins. Under GF1 if the margin dropped more than 15% below the reference margin the farmer would get a payout. This formula means that farmers that have significant losses over several years may not receive any support, as their reference margin becomes less than zero.

AgriStability is more often used by livestock farmers, including large specialized farms such as intensive hog operations and large beef feedlots, than by grain farms and mixed farms, because livestock markets are more volatile than grain markets, and because the diversity of mixed farming means that losses in one aspect of the operation do not drag the whole farm's margin below the reference margin. The way AgriStability is set up it also rewards highly risky behaviour by grain farmers who plant a large proportion of their farm's acres to one crop, hoping for a high price, but knowing that AgriStability will pick up the pieces if the price collapses. AgriStability promotes "putting all your eggs in one basket" because if the price of "eggs" collapses or you lose the crop to disease or pests, you'll get an "omelette" from the BRM program. This is questionable behavior from both a business and an ecological standpoint, and thus should not be encouraged by policy.

On-farm diversity provides a certain amount of resilience. AgriStability, in contrast, rewards the more brittle enterprises, especially those that are highly exposed to the export market. This creates an unfair situation when large specialized farms are competing with smaller diversified farms in the same market. The lack of competition among large federally inspected meat processing plants in many regions of Canada also serves to depress prices for farmers, and AgriStability may also be working as an input subsidy to those companies.

AgriStability's support for large specialized export-oriented production means that the public dollar actually subsidizes prices to foreign buyers, contributing to loss of livelihoods for local farmers in other jurisdictions. These displaced farmers may well end up in cities abroad where, in order to survive, they must take low-wage jobs, a dynamic that contributes to global political instability.

The federal government is considering changing the AgriStability trigger to a 30% drop below reference margins under GF2. If that is implemented, only those farms subject to extreme volatility would be eligible for support. The new trigger may well function as an administrative tool to carry out a political goal – that of the elimination of AgriStability as a BRM program. Perhaps the idea is to replace AgriStability with some form of price insurance, as was suggested by the Agriculture Committee.

- ***The National Farmers Union recommends maintaining the 15% margin loss trigger for AgriStability***

AgriInvest

AgriInvest is a savings account for producers to manage small income declines when their margin drops by less than 15% below their reference margin. Producers can deposit up to 1.5% of their net sales of eligible products and get a matching government contribution of up to $22,500. Withdrawals can be made at any time. Representatives of large feedlot operators and commodity groups want to eliminate the $1.5 million cap on this program. Family farmers are quite happy with AgriInvest the way it is. Raising the cap could lead to rapid depletion of the allocated funds or pressure on administrators to avoid payments in order to meet budget restraints. According to the Census of Agriculture, there are fewer than 10,000 farms with $1 million or more in annual revenue.

- ***The NFU recommends that AgriInvest lower the eligible sales cap to $1 million per year. This would still include 95% of Canadian farms in the program.***

- ***The NFU recommends a sliding scale for the government contributions to AgriInvest accounts. On deposits based on eligible sales up to $250,000 AgriInvest would continue to match 100% of farmers' deposits. On sales from $250,000 to $500,000, 75% of deposits would be matched, and on sales over $500,000 up to the cap of $1 million, 25% of deposits would be matched.***

<u>AgriInsurance</u>
AgriInsurance is Production and Crop Insurance, administered by the Provinces. Payment for the premiums is shared -- the federal government pays 36%, the province pays 24% and the farmer pays 40%. The proportion of premiums paid by farmers has risen from a low of 29.2% (in Saskatchewan) in 2000. There are various options for level of coverage and types of hazards in provincial crop insurance programs, however not all farms benefit from crop insurance so there is less than 100% coverage overall.

- ***AgriInsurance is a valuable program and the National Farmers Union recommends that it be maintained with the same level of government support.***

<u>AgriRecovery</u>
AgriRecovery is short-term disaster assistance for losses not covered by any other program, and is funded on a 60:40 ratio by the federal and provincial governments. Whether a situation meets the criteria for AgriRecovery assistance is evaluated on a case-by-case basis. Witnesses to the Agriculture Committee expressed concern that the definition of a disaster for AgriRecovery purposes seems to be somewhat arbitrary. There is a risk that a precise definition could exclude situations that were unforeseen, however. The goal of AgriRecovery should be to help farmers manage during, and recover from disasters and to prevent losses (such as slaughter of breeding stock) due to disasters that would impair future viability of the farms and their ability to supply food to our communities.

Many of the disasters that have occurred recently are due to extreme weather events, such as prolonged drought, flooding, prolonged and/or untimely temperature extremes, wildfires resulting from hot, dry weather plus lightning strikes, weather-related disease issues, severe storms and tornadoes. The increasing frequency and severity of unusual weather is a result of the increasing energy stored in the atmosphere by heat-trapping chemicals such as CO2, methane and nitrous oxide that are produced by industrial processes. Canada's withdrawal from the Kyoto protocol, the cancellation of numerous programs that mitigate climate change and reduce levels of greenhouse gas emissions, the closure of climate-change-oriented research institutions and the strong support for expanding the oil and gas sectors are all at cross purposes to the AgriRecovery program. Weather has a far greater effect on yields than any other factor. Climatic volatility is a serious business risk for agriculture which needs to be addressed broadly by policy in all areas and levels of government.

- ***The National Farmers Union recommends that the federal and provincial governments make climate change mitigation and adaptation a top priority.***

Access to disaster relief for floods and droughts is increasingly being tied to participation in AgriInsurance programs. While a large number of farmers use Crop Insurance, there are many who prefer not to use it, either because the insurance does not effectively cover the kind of production they are engaged in, or because they prefer to manage their own risk. These people do not draw on the public purse for support payments in normal years. Disasters are, by definition, extreme occurrences that could not be predicted and for which it is impossible to prepare. Insurance companies generally exclude disaster coverage from their policies simply because the risks are unknowable. Farmers who choose not to purchase crop insurance that may not adequately cover their production risks should not denied help under AgriRecovery, which would mean extreme losses in the face of disaster. AgriRecovery commitments and payments need to be made in a timely manner so that farmers can proceed with recovery efforts as soon as possible.

- ***The National Farmers Union recommends that all farmers affected by a disaster be eligible for disaster relief under AgriRecovery regardless of their participation in other BRM programs.***

Price Insurance programs
Ontario and Alberta offer some programs to deal with price-related risks, which would allow producers to insure against downturns in their commodity's price, guaranteeing them a floor price. The Alberta cattle price insurance program is based on an index tied to the Chicago Mercantile Exchange; however there has been limited uptake by farmers. The House of Commons Agriculture Committee was enthusiastic about this approach and recommended the government look into setting up national price-related insurance programs.

It is not clear how the government would participate in a price insurance program without triggering a trade challenge. The federal push for ever-increasing agri-food exports means that commodities such as beef and canola are subject to increased risk of market volatility as a result of federal policies. Meanwhile, producers of fruit and vegetables are seeing their markets shrink as Canada's trade negotiators allow ever more Canadian market access for imports, while the Canadian Food Inspection Agency does not properly enforce Canadian product standards for imports. Price insurance for export-oriented products, if cost-shared with governments, would likely be seen as an unfair subsidy by our trading partners. If it not cost-shared with governments it would put an increasing burden on farmers to shoulder the risk created by the government's trade goals.

AAFC has also hinted that the government would like to see more private risk management in agriculture. If the goal is to replace AgriStability with a completely private insurance system, it is difficult to see how it could be actuarially sound and remain affordable for farmers. If insurance was used to manage risk in international commodity markets, premiums would have to be very high in order to provide for payouts during severe and/or prolonged downturns. If the insurance provider under-estimated market volatility, it would either go bankrupt and not pay out, or it would call upon the government to bail it out. If the insurance over-estimated volatility it would be highly profitable, and that profit – dollars paid out by farmers -- would go to the company's shareholders instead of being invested in Canadian farms.

Price insurance would be a very high stakes game, and it is unlikely that most small to medium-sized family farmers would be able to afford the premiums. Adopting a private price insurance scheme to replace BRM programs would accelerate the trend to large, corporate farms with each turn of the volatility cycle.

- ***The NFU recommends that any price insurance proposal be presented in detail for meaningful farmer consultation and approval, that any proposed price insurance scheme be publicly funded, and that it not be used as a replacement for other risk management programs.***