Podcast

60-65% of farmers are risk averse (I think this is about the same as the rest of the population…)

Many tools available to manage risk

* Managing risk in other ways is cheaper
* Farmers are willing to pay very little above expected return on crop insurance
  + Loading factor: percentage above the expected return
* Low WTP for crop insurance
  + Bodsley study, 30 years ago.
  + Brian Wright, UC Berkeley
* Insurers require much higher loading factor (60-70%)

If it is expensive to offer, and farmers aren’t willing to pay for it, then why offer it?

* Plausible story for farmers to acquire subsidies
* Origins are very political
* Farming is risky, but no more risky than other industries
* Taxpayers pay $7-8 billions of premium a year, $3 billion is paid by farmers

Why not mandate instead of subsidize?

* Farmers have a lot of political power

Transferring risk to the taxpayer allows them to take even more risk

Subsidies widen the pool of insurance, lower risk of adverse selection

* The converse: loading up the moral hazard problem

Private company tries to solve adverse selection problem by creating high risk pools and low risk pools.

With subsidies, make it profitable for everyone to get into the same pool.

Moral hazard.

* Work by the Smith, Barry Goodwin, Bruce Babcock, David Hennessey.
* If you buy crop insurance, you are less likely to apply herbicides, pesticides, more likely to go into marginal production areas,
* Work on Kansas. Cut back on the use of agricultural chemicals by a third if they had insurance

Welfare effects

* Why haven’t we looked at total welfare effects?
* Bardsley sort of gets at this, but it hasn’t really been done
* Studies have focused on producer surplus
* Every dollar spent by taxpayers is a deadweight loss. Holy crap.
* All of the producer and consumer surplus is coming out of the taxpayers funds.
* No one has done a full welfare analysis of this. That is insane…

How much of this producer surplus is wasted on rent-seeking behavior?

* Agricultural insurance lobbyists…
* Per farmer, there are a lot more insurance agents in Iowa, then in N Texas/Montana, etc
  + Look at underwriting gains… profitability of business
  + Compensation rates paid to agents. Varies by region.
  + Wasted resources

Paper on weather index insurance in developing countries

What prevents a global private industry?

* Same problems in developing countries as in developed countries
* Is crop insurance or weather based index insurance a viable tool?
  + Probably not
* Some companies offering weather derivative type insurance. In Canada and US. Same companies providing weather derivative insurance for Macys for snow storms.
* Problem with pushing aid money into insurance products: is that a good use of money?
  + Serious concerns about whether this is a good investment
  + Dollars have VERY high opportunity cost in these countries
  + Ethical issue, extremely important

Crop insurance and WTO rules

* Presented as non-product specific policies, so don’t violate the rules
* These seem to affect trade.
* A good case could be made that crop insurance violates these rules

Mariam Miranda and Katy Faren

Vince Smith and Joe Glauber