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Protecting farmers' interests

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THE need to provide some kind of insurance cover to protect the incomes and outputs of farmers from the vagaries of the weather, natural calamities (like pest attacks) and price fluctuations, despite modernization and technological improvements, has often been raised but without being subjected to any serious debate.

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Across the border in India, crop insurance, essentially covering yields/output (and not crop income directly) delivered by rural finance institutions, is being used to provide protection to farmers. The instrument of crop insurance is linked to crop loans and its cost is partly financed through government subsidies (especially to cover small and marginal farmers).

It is, however, intriguing that despite the high claims to premium ratio (more than 400 per cent) only 10 per cent of the cropped area in India is covered, whereas the above mentioned high ratio should have attracted more farmers to the scheme.

It is time to give this issue a serious thought, especially now that the Bank of Punjab is planning to introduce agriculture crop insurance. To this end, this article makes recommendations on how best to introduce such an instrument by highlighting the major factors that will have to be taken into consideration for its development.

The foremost problem is that risk in agriculture is largely systemic in nature and cannot be reduced through "pooling of risk," a critical condition for making any activity insurable. Consequently, in agriculture, the assessment of the risk, and thereby the level of the insurance premium, is likely to require coverage on an area basis (for a crop like wheat or cotton or a combination of major crops), as opposed to an individual farmer basis, since the estimates would have to be based on an average risk and loss aspects of this specific area as a whole.

Farmers of a specific/identified homogeneous geographical area will all have to be viewed as identical in terms of the degree of risk and loss and hence will be required to pay the same premium and also be entitled to a claim of the same value (on a per care basis). Such an approach would not only be an administratively more convenient approach, but would also help minimize manipulation and the incentive to be reckless. Moreover, it would also be mandatory on all farmers in the area to participate in the scheme.

Tying a crop loan to its insurance would strengthen the scheme and also reduce the risk for the financial institution (thereby, lowering the interest rate on the loan). To minimize administration costs the premium could be deducted at source from the disbursement of the loan.

However, for the area-based approach to get off the ground would require adequate historical data over a number of years on crop yields of, and of rainfall and pest attacks, in such a defined "area".

Insuring the income of the farmer from a particular crop will require that he be covered for the difference between guaranteed income (to be determined by multiplying the lowest acceptable yield per acre with the crop support price announced by the government) and the actual income (which would be a function of the actual yield and the prevailing market price).

To minimize the incentive to manipulate income, "actual" market price will have to be accepted as being within a range of say 90 per cent and 125 per cent of the support price. However, the amount to be paid to a claimant need not be based on an estimation of the loss and could be predetermined.

The element of risk would have to be shared between the insurance company and the government, with the latter's contribution being in the form of a subsidy. Luckily any crop insurance subsidies of this nature that may be required to operationalize the scheme in the initial period are not likely to run foul of WTO regulations.

Over time the quality of the crop insurance scheme will improve because of better crop estimation techniques resulting from the use of new technologies, improved forecasting and superior methods of prediction about weather conditions.