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RMA Administrator
USDA/RMA/Stop 0801
Room 6092-South
1400 Independence Ave., S.W.
Washington, D.C. 20250

National Pork Producers Council Comments Regarding *Study on Swine Catastrophic Disease*

These comments are submitted on behalf of the National Pork Producers Council (NPPC). NPPC is an association of 43 state pork producer organizations that serves as the voice in Washington for the nation's pork producers. The U.S. pork industry represents a significant value-added activity in the agriculture economy and the overall U.S. economy. Nationwide, more than 68,000 pork producers marketed 107 million hogs in 2014, and those animals provided total gross income of more than $26.4 billion. Overall, an estimated $22.3 billion of personal income and $39 billion of gross national product are supported by the U.S. hog industry. Economists Dan Otto, Lee Schulz and Mark Imerman at Iowa State University estimate that the U.S. pork industry is directly responsible for the creation of more than 37,000 full-time equivalent pork-producing jobs and nearly 102,000 slaughter and processing jobs. All told, the pork industry supports nearly 550,000 mostly rural jobs in the United States. Pork exports have averaged more than $6 billion in recent years and represent nearly a quarter of total production.

The Agricultural Act of 2014 amended the Federal Crop Insurance Act to direct the Federal Crop Insurance Corporation (FCIC) to commission a study to determine the feasibility of developing an appropriate insurance program for swine producers as protection against a catastrophic swine disease event (CSDE). NPPC appreciated and supported this endeavor since the threat of foreign animal diseases entering domestic production channels poses a real threat to the economic well-being and vitality of pork producers, input suppliers, packers and processors and other players in the agri-food system. Because of the importance of international markets to the American pork producer, the threat and potential losses from a CSDE scenario grow exponentially when taking into account the ripple effects it would have on the rest of the rural economy. This dependence on exports in the absence of a safety net is a very serious concern and one that should not be taken lightly.

Unfortunately, it is clear from the December 2015 final report titled *Study on Swine Catastrophic Disease* that the very real and legitimate consternations of the $26.4 billion pork industry were not taken seriously. Overall, the report is a very weak attempt at explaining why such a safety net is infeasible, and it is clear there is a severe lack of institutional knowledge in formulating the report. At first read, one may conclude the authors of the study show little concern for the very legitimate concerns of the pork industry, and perhaps do not fully appreciate the potential consequences of a CSDE. By not giving the issue of catastrophic disease insurance for swine its due diligence, America's pork producers are left out to dry and open to the risks associated with a CSDE. Meanwhile, other industries in the agricultural community are offered insurance

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programs to provide some semblance of certainty in the wake of disaster. America's 67,000 pork producers deserve better and deserve a better attempt at determining the feasibility of such a program.

The report lists six main reasons for arriving at the conclusion that it is not currently feasible to develop an appropriate insurance program to provide protection against a CSDE. While this may be the case today under the current rules of the game, it is our opinion that the report lacks the creativity and thoroughness to determine, as the legislation states, "the feasibility of insuring swine producers for a catastrophic event"; that is to say, the report does not address whether or not a program *could* be developed to insure against a CSDE. It is our belief that such a program not only is feasible but also necessary for the pork industry in particular and society as a whole.

In Section 7.7.1, the report's first and foremost justification for ruling such a program infeasible is the statutory cap on expenditure. The 2000 Agricultural Risk Protection Act established two pilot programs for livestock: Livestock Risk Protection (LRP) and Livestock Margin Protection (LMP). As is typical for a pilot program, an expenditure cap associated with conducting the programs was established, in this case $20 million. While this made sense at inception, there has been enough time for data collection and excellent loss-ratio outcomes to take place to render this unnecessary. Instead, the cap severely limits the number of producers who can participate in the risk management programs and restricts the number of head that any one producer can insure. Thus, this limit effectively prohibits large-scale producers from participating. Ultimately, this has the potential to pit large operations against smaller producers.

Section 7.7.2 indicates many hog operations have no insurable interest because of contracts with growers to manage hogs provided and owned by the contractor. There are, however, a number of different ways to determine the insurable interests of the growers if the authors of the study would have attempted. There is no evidence of any effort to try and accomplish this objective. Furthermore, the contractors and/or packers certainly do have an interest. Because of the statutory cap on expenditures and the limit on the number of animals to be insured, these large players in the industry are not able to participate in the existing programs administered by RMA.

Section 7.7.3 of the report states that producers would not be able to provide coverage for the lengthy period over which losses might occur. This is incorrect for two reasons. First, the document incorrectly states that RMA policy is to cover only current inventory. If this were true and taken literally, RMA would not be able to offer protection for crops that have yet to be planted. Second, the report states that the plan would not be able to cover the period after the current inventory has been sold. This is not true. Mechanisms have been developed to offer insurance protection for several years into the future[1]. In fact, the problem with short-run coverage exists with the preferred alternative proposed by the authors: that of purchasing options on the CME. These options seldom trade for more than one year into the future[2].

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[1] See Hart, Chad E., Sergio H. Lence, Dermot J. Hayes, and Na Jin. "Price Mean Reversion, Seasonality, and Options Markets." *American Journal of Agricultural Economics* (2015): aav045.

[2] See Jin, Na, Sergio Lence, Chad Hart, and Dermot Hayes. "The long-term structure of commodity futures." American journal of agricultural economics 94, no. 3 (2012): 718-735.

While it is true that existing mechanisms for risk management are available, as the report's Section 7.7.5 states, it is not our belief that this is a justifiable argument against the development of an insurance product. As the report states, "Integrators and producers can and do use futures and options to manage price risk." The fact of the matter is that many producers lack the necessary skills and time to utilize these options markets throughout the year while simultaneously being charged with the task of procuring inputs, ensuring the highest levels of animal welfare, managing employees and ultimately producing a safe, wholesome and nutritious food product for consumers. The demand for these financial products is limited because liquidity is limited after about a year in the agricultural options marketplace. It is also generally accepted that options are overpriced, as CME option writers must earn money for their services. Furthermore, futures and options markets have been in existence for decades in the grain industry, yet there remains a federal crop insurance program.

If the existence of futures and options is a sufficient justification to keep the pork industry from having access to an insurance product, how is the current crop insurance program justifiable? It is unclear why the existing mechanism for risk management would be used as a reason for declaring the infeasibility of a catastrophic insurance product for the pork industry and not thoroughly defended in the report.

The report states that producers would be unwilling to pay the cost to participate in such a product offering in Section 7.7.6 because participation in LRP and LGM plans is negligible. But as discussed above, the statutory cap on expenditures essentially removes a large portion of the pork industry from being able to participate. Furthermore, in pricing the LGM product, RMA added a load on the premium paid by producers on top of the overpriced options prices from CME. Furthermore, the swine product is not subsidized, unlike the dairy product. To compare participation in the dairy and swine products is quite literally comparing apples and oranges because of the subsidy. These items of information are critically important to understanding why the existing products have experienced low sales in the past.

It is well documented that volatility in the livestock industry as a whole, and the pork industry in particular, has increased in recent years as a larger share of domestic production is exported and because of the ethanol mandate. Over the past several years, we have witnessed the effects of Porcine Epidemic Diarrhea virus (PEDv) in the pork industry and its effects on supply. Likewise, the poultry industry has been forced to deal with highly pathogenic avian influenza and the economic fallout that it brings. A catastrophic insurance product could, and should, be developed in the wake of increasing reliance on foreign markets, coupled with the very credible threat a CSDE presents. This product could feature a very simple subsidy as basic coverage for participating producers, with the option to "buy-up" additional coverage if desired. Very simple modifications to the LGM product could make this happen.

If even a portion of the $6.5 billion export market is lost because of a disease outbreak, product that might otherwise have been exported will flood the domestic market and drive prices lower. This line of argument has been used to dissuade the pork industry from investing to expand exports. Agricultural exports benefit the United States as a whole and are often described as one of the success stories of the USDA. How can the industry continue to push for increased exports and reliance on foreign markets without the certainty of a safety net to protect it from a domestic

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disaster? In the absence of this coverage, leaders of the pork industry will voice legitimate concerns about the value of expanding pork exports.

The objective here is not to make producers whole in the event of a CSDE; rather, the objective should be to find a meaningful solution to serve as a shock absorber for the 68,000 pork producers across the country. This sort of shock absorber exists in other domestic agricultural industries. If export markets were to close, the equivalent of 20-25 percent more pork would be dumped on the domestic market. It is our belief that a catastrophic insurance program could be developed to provide basic assistance to producers while at the same time allow for market signals to continue to be transmitted among market players.

Of course, removal of the statutory cap would require approval from Congress. It is clear, for the reasons laid out above, that its removal would address the majority of the concerns raised in the report. The cap currently pits large-scale producers against smaller producers and leaves the larger producers on their own to address the risks involved with a CSDE. The bottom line is we cannot have a meaningful discussion about adequately insuring the industry against the threat of catastrophic diseases until the cap is lifted.

It is clear that the report did little to address the concerns it sought to address, or to address the legitimate concerns of the industry. Insuring swine producers for a catastrophic event is an endeavor Congress, USDA and others should take very seriously, as they have done for other industries in the American countryside. We believe a catastrophic insurance product is not only feasible but also necessary for the well-being and longevity of rural America.

To address the many shortcomings of the *Study on Catastrophic Disease*, we would like to request a meeting between pork industry leaders and leadership at RMA to further discuss the need for a swine CSDE insurance program.

NPPC appreciates the opportunity to comment on this report. We look forward to working with RMA to provide the U.S. pork industry the tools it needs to continue to thrive in the 21st century and to protect producers from catastrophic swine diseases.

Sincerely yours,

Ron Prestage

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