



Registered Farm Stabilization Plan

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PROPOSAL FOR A CAIS DEPOSIT REPLACEMENT

INTRODUCTION

The CAIS Deposit requirement is redundant and does not meet its goals. This has also been agreed to by Minister Mitchell and many AAFC staff. The topic at hand is not to discuss the deposit requirement itself but to find a replacement.

As outlined in the principal objectives set out for the Agricultural Policy Framework and its Business Risk Management programs, the CAIS program should:

- 1) Encourage producers to actively manage their business risk,
- 1) Facilitate long term planning by producers,
- 2) Producers should share in the costs of the program,
- 3) Sharing of the costs of the program must be affordable to producers, and
- 4) The design must be practical.

As we in industry have stated, the CAIS program, even without the deposit requirement, maintains these objectives.

Producers are active participants in the management of all facets of their farm businesses. For every dollar lost by a producer, CAIS only covers a portion of that loss. It is in the best interest of every producer to find the best market price and minimize their business risk because it affects their bottom line. The incentive to minimize business risk remains, regardless of whether or not there is a deposit.

The reference margin set by CAIS is based on a moving average of margin years, and thus the reference margin changes with long-term trends. Again, it is in the best interest of every producer to maintain a high reference margin and therefore mitigate long term declines. A deposit contributes nothing to this incentive.

Because CAIS only covers a portion of a margin loss, producers are already sharing in the cost of this program. In Tier 1 of CAIS, where many of the payments will come from, producers are sharing that cost 50-50. The deposit does not change that cost share.

We make these points to underline the concept that the objectives are being met, despite the elimination of the deposit. In fact the elimination of the deposit will further the objectives of

affordability to farmers and design practicality. We note here that any 'replacement' policy to achieve the objectives shown above will only create duplication and complexity to the program.

Finally, we outline one other objective, specific to the deposit requirement. The Deposit requirement was also to be act as a producer rainy-day savings fund. The deposit was to be a producer's self savings, used to stabilize incomes in bad times - a laudable goal. Clearly the deposit did not achieve that objective but perhaps a suitable replacement can be designed.

OUR CURRENT IMPASSE

It has been agreed that the deposit needs to be eliminated. How to move forward is the key. While we in industry believe simple elimination with no replacement is optimal, others have stated that a replacement is needed. For the issue to move forward a compromise must be reached.

DEFINING CONSTRAINTS

From the industry perspective:

1) Any replacement cannot add any upfront costs. Affordability of the program is a primary principle to producers. Regardless of whether it is a deposit, non-refundable fee or deductible, we do not support the imposition of increased costs to the program. Replacing the deposit with a fee will not remove producers' concerns with costs. Producers already share in the cost of every dollar lost. Considering many programs offered by our trading competitors have no costs to producers, these administrative "engagement" requirements only serve to further Canadian producers' competitive disadvantage. Canadian producers cannot be further disadvantaged on the international stage.

2) The CAIS program should not and will not evolve to an insurance based program.

From an administration perspective:

3) Any replacement should promote the concept of "active risk management". From our understanding of the administrative interpretation of that term, any replacement is to ensure that producers actively consider and choose their level of coverage under CAIS.

4) Any replacement should also discourage producers from opting in and opting out of the program.

5) Any replacement should encourage producers to constantly submit their farm production data.

First of all, let us eliminate the concerns surrounding constraints 4 and 5. A mandatory application for all CAIS participants has been proposed regardless of if they are to trigger or not. Further, there already exist penalties for opting in and out of the program. These two concerns can easily be overcome.

A PROPOSAL IN CONCEPT

Thus far, all proposals for a deposit replacement have entailed some kind of incentive for producers to choose a level of coverage, some kind of active 'choice' - a fee, a premium, a deposit. All proposals have been in fact disincentives to choose full coverage - a larger deposit or a higher premium/fee.

From our perspective, we would like to develop a replacement that encourages the concept of a producer rainy day savings fund. Essentially, it is a fund in which producers actively engage in self-savings in good years to stabilize for bad years. Currently, producers are ill-able to achieve self-savings using conventional methods. Extremely variable markets and climate make such actions difficult and thus the need for programs such as production insurance and CAIS.

Self-savings however cannot be forced. The deposit was not self-saving and only held a large sum of cash fixed, unable to be used to help the farm. Any self-savings must be allowed to build in good years and spend in bad years. There must be incentives for one to save.

To marry the two concepts of producers having the incentive to choose their level of coverage under CAIS and the concept of producer self-saving - we propose a positive incentive system towards producer self saving, dependent on the level of coverage chosen.

In concept:

- 1) A positive incentive for self-saving is given to producers irrelevant if they are in CAIS.
- 2) If a producer signs up for CAIS and chooses 100% coverage, the positive incentive for self-savings is at its lowest.
- 3) As the level of coverage decreases, and therefore the greater the responsibility taken on by the producer, the greater the incentive to self-save
- 4) For those not signing up for CAIS, they will receive the highest incentives for self-savings as they bear 100% of the responsibility in the event of an income drop.

The concept is simple - the greater the level of responsibility taken on by the producer, the greater the tools given to him/her to self-save.

FROM A CONCEPT TO A SPECIFIC PROPOSAL: A REGISTERED FARM STABILIZATION PLAN

KAP's business risk management committee has developed an option, for consideration by governments and farm organizations. This option consists of a registered account and it has distinct advantages for farm organizations. The concept allows farmers to be responsible for a percentage of stabilization and investment within their operation. This approach would allow farmers access to a rainy day fund. It also gives farmers the access to dollars to help manage the top 30% of stabilization (Under CAIS) and the ability to cover the 8% drop which is the producer's responsibility.

Details of a Registered Farm Stabilization Plan (RFSP):

- Dollars would be deposited before tax in a registered account and it could be accessed when the farmer chooses to do so.
- This option does not require triggers, investment from government, or administration by government.
- The structure would be one of any registered plan, such as a RRSP.
- The dollars deposited into a RFSP would be counted in the reference margin and deposited before tax. Tax would have to be paid on the dollars when they are withdrawn.
- If the account is built up, it could be used for cash flow crisis for capital investment, intergenerational transfer, etc.
- A contribution level would need to be established that could be deposited in the plan in any given year, possibly a percentage of the reference margin or a percentage of gross farm receipts.
- If a producer cannot meet his/her contribution in one year, the contribution amount can be accumulative, so if a producer has a good year he/she can top up the RFSP.
- The farmer has the option of withdrawing funds for any reason, but we believe it will facilitate activity in the other pillars of the APF, such as environment, renewal and improvements to meet industry guidelines as it relates to food safety. This has the potential to fall within all components of the APF.
- Producers could be given the option of rolling their NISA funds into this to help with start up and this would also serve as an incentive for producers to use the RFSP.
- When nearing retirement, a producer would have to start drawing down on the plan, otherwise, he/she would have to pay taxes on the farm income upon retirement.
- Another area that could be explored is the possibility of transferring the fund with the farm for intergenerational transfer.

To include the government concept of "active participation" we define an RFSP base cap and level of CAIS coverage will build upon that cap.

- Those that sign up for CAIS and choose 100% coverage will receive the base cap. We propose that base cap be set at 8% of CAIS reference margins - the portion of CAIS coverage that has never been accounted for. Therefore for a reference margin of \$100,000, the producer can put aside up to \$8,000 a year into an RFSP tax free, in the interest of it being a producer self-saving stabilization fund.

- Those that choose to sign up for CAIS at decreasing levels of coverage will receive X% more RFSP cap space for every 5% reduction in CAIS coverage. Example - if the X% is set at 1% more RFSP cap space for every 5% reduction in CAIS coverage, if a producer chooses 80% CAIS coverage, the producer's RFSP cap is now 12% of their CAIS Reference Margin. At a Reference Margin of \$100,000, this producer can now put up to \$12,000 into their self-stabilizing fund. If the producer chooses the 70% minimum, the producer's cap space will be 14% of CAIS Reference Margins. The more risk the producer takes onto him/herself, the greater the ability to self-stabilize is provided.

- Finally, for those that decide not to enter CAIS, bearing 100% of the risk themselves, they are given a max cap, set at some level greater than the base cap plus the maximum additional cap space available under CAIS.

CAUTIONARY NOTE

Because both CAIS and any RFSP will be income based programs, interactions between the two must be considered. The programs need to be designed such that one stabilization does not offset the other.

It must be made clear that income reported as farm income under CAIS cannot be reported twice. Under this program, in a good year, a farmer should take a portion of his/her CAIS eligible farm income and put it aside in an RFSP. In the event of a poor year, the farmer should be able to withdraw this money and this income should be considered non-eligible income under CAIS. The reasoning is this, any normal self-savings a farmer does would be considered in the same fashion. Money withdrawn from savings funds in the event as a bad year could be returns from dividends, bonds or other investments. RFSP funds should be considered the same. Further, if funds withdrawn from the RFSP are considered eligible incomes under CAIS, the RFSP would become a complete CAIS offset and will serve no positive purpose. Under such rules, a farmer would never draw from their RFSP in the event of a bad year and would instead wait for a CAIS payment. This would nullify the stabilization purpose of the RFSP.

CONCLUSION

The concept of a registered farm income stabilization plan is not a new one. Other Canada-like countries have similar programs - namely New Zealand and Australia. Their programs are similar to the proposed RFSP and have worked well to give farmers the proper tools to stabilize their incomes.

In concept this proposal maintains the principal objectives set out in the APF for Business Risk Management: active risk management, long term planning, producers sharing in costs of the program, program affordability and design practicality.

Under this program:

- Producers will consider the long term stabilization of incomes by self-stabilizing. The program gives incentives for producers to put aside income in good years and stabilize in poor years.

- The program is no more complex than the deposit requirement and will take away much of the administration from governments.
- Lending institutions will lose the deposits from their accounts but gain RFSP accounts.
- Stabilization funds for this program are fully producer dollars and governments will not make any direct payments into this program.
- Because the account will be completely producer controlled, its stabilization will be timely, providing funds at the precise times when stabilization is needed.
- Achieves industry goal of 1) no upfront costs and 2) no movement to an insurance based system.
- Achieves government goals of active risk management, providing producers the incentive to consider and choose their level of coverage.