

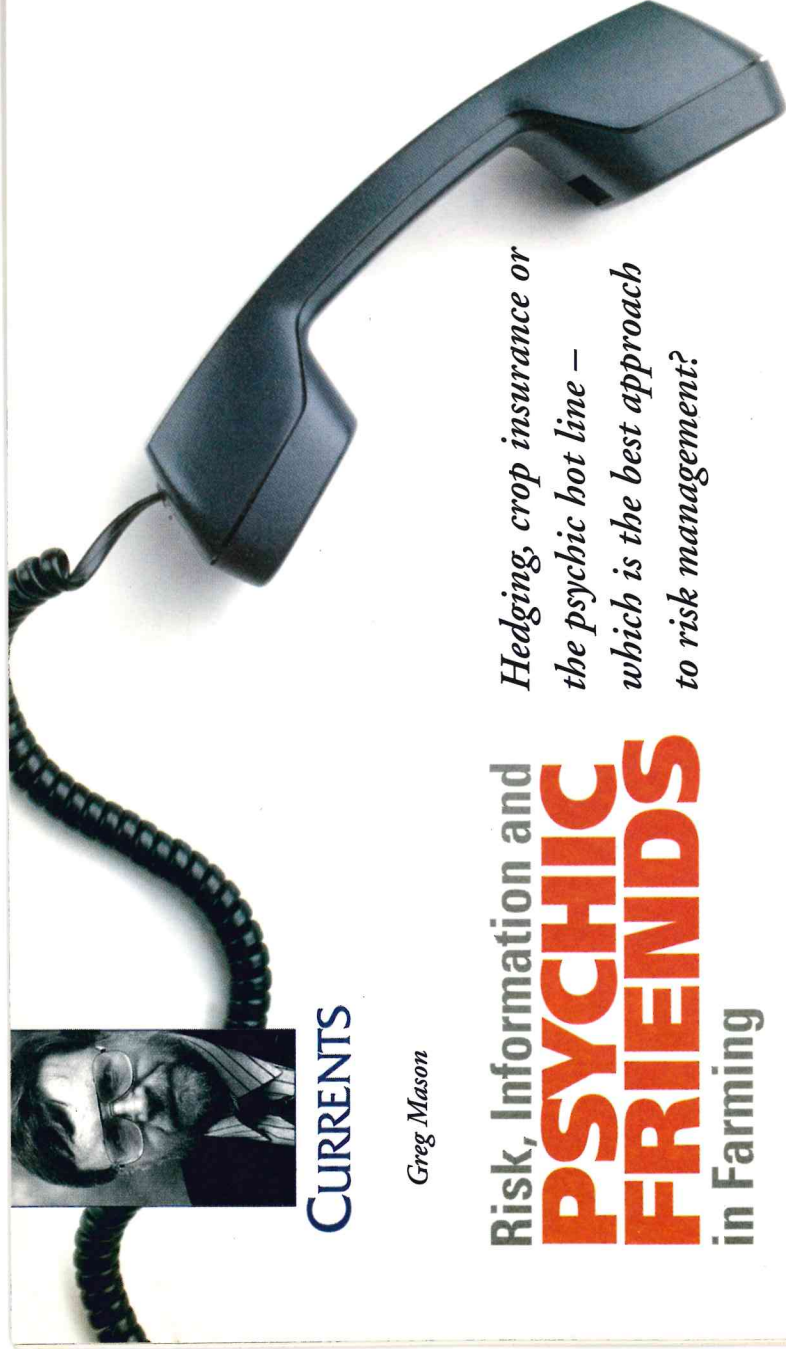


CURRENTS

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Risk, Information and PSYCHIC FRIENDS in Farming

*Hedging, crop insurance or
the psychic hot line —
which is the best approach
to risk management?*



Farming is risky. Every producer knows this, but many do not use the full range of techniques available to manage risk. Given all the uncertainties faced by farmers, maybe psychics are the answer to risk in farming. I know in our business, this sometimes seems as good as any other method.

With the wettest and latest spring in many years on the prairies, many farmers, especially in Manitoba, raced to complete seeding within the deadlines set by crop insurance. Everyone assumes that later seeding leads to lower final yields. However, as Morris Dorosh recently showed in *Agriveek*, his informative weekly newsletter, no correlation exists between the date of seeding and final crop yield. The most common response to risk is to get more data. Looking at historical records is the best forecast we have for the future. Of course, history rarely repeats itself exactly and weather records are set to be broken. Consequently, gathering data has limitations as a risk management technique.

Gyrating prices are another farming risk. In April, wheat prices broke through historical highs and many farmers reversed the trend of planting canola, increasing their commitment to grains. In mid-June, wheat prices softened in response to new information that farmers in other producer countries had done the same thing. It seems that world supply shortages may not be as severe as originally expected. Increasing numbers of farmers hedge to manage the risk from price fluctuations.

Recently, I interviewed several producers who had used this technique. All of them had planted about the same acreage in canola; one reported that hedging had produced profits, another reported break-even and the third complained about a substantial loss. On balance, these farmers experienced exactly what hedging does — it removes the risks but the average return is zero. A basic truism in the investment world is that riskless returns are low — on average.

Many farm advisors advocate diversification. This approach to risk management in farming is common to financial

manage risk. Insurance is really a form of hedging. The deadlines set by crop insurance programs prompted the panic over late seeding in May. Some believe that crop insurance is an essential farm expense, but I know several producers who “self-insure.” By diversifying activity, spreading their farming activity across several miles and using off-farm income, these farmers believe that they are managing risks adequately. The cash for insurance premiums may be better used elsewhere in their farm operations.

Managing business risk is essential to the total operations of the farm. Most

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investment. Financial advisors recommend a diversified portfolio to reduce the potential losses resulting from investing in a single stock or bond. As many farmers are finding, however, diversification is complicated and not available to all. For example, diversification opportunities are greater in central Saskatchewan than in the southern part of the province because of soil and weather conditions. Diversification is a broad concept. It includes renting land in several locations to “spread” the risk from weather. Also, many families diversify revenue sources by using off-farm work as an essential income to maintain their viability.

Finally, like all businesses and homeowners, farmers buy insurance to

farmers will use a variety of techniques, but none is foolproof. Ironically, one needs to have a diversified approach to risk management.

Of course, no one has perfect foresight, except perhaps our psychic friends on late night television. Learning their answer to a question about how much wheat to plant would be interesting. Then again, the \$5 a minute call to your personal psychic just might be better spent on chemicals. ▀

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