

**DEVELOPMENT OF INSURANCE AGAINST FORCE MAJEURE
INCIDENTS IN AGRICULTURE IN POLAND**

(Elements of the risk management system)

Polish agriculture, similarly to the agriculture in the whole Europe, is subject to the consequences of changeable agrometeorological conditions of production:

- **droughts**, which are increasingly frequent. The volume of damages resulting from droughts is influenced by agricultural land turning into steppe in Poland. This year's drought resulted in damages in the plant production exceeding EUR 1.5 billion;

- **too low temperatures** (late frost and bad overwintering). It is assumed that exceptionally severe winters happen in Poland once in several years;

- **floods**. This risk poses a threat to agricultural holdings located on the banks of the Oder River and the upper Vistula, as well as their tributaries. Poland, especially the mountain areas in the southern part of the country, is exposed to local floods. The flood of 1997 caused damages of EUR 1 billion to Polish agriculture.

Global agroclimatic changes (warming) or increasing contamination of the atmosphere increase the damages caused by force majeure incidents, cause increasing fluctuations of production and result in the variable economic situation of agricultural holdings and businesses.

There is a growing awareness that disintensification of agriculture, which is a consequence of the transfer to the market conditions of production in Poland and the advancing CAP reform in the EU, decreases the opportunities to prevent those negative phenomena or to alleviate their consequences (decrease of the use of fertilisers and chemical products, and irrigation).

Due to all this, the risk of management increases and thus the importance of risk management also increases. It begins to be a significant problem of CAP which

is reflected by increasingly frequent discussions on the subject by the EU agricultural and economic bodies. Today's conference is a proof of that as well.

The threat of another occurrence of disastrous damages forces us to seek other system solutions to guarantee insurance protection to agricultural producers.

Poland has a relatively long history of the application of systems and instruments mitigating the consequences of random incidents in agriculture.

1. During the period of central economy they were obligatory systems, in selected areas of risks and damages, in monopolised state insurance systems.

The insurance was common and partly subsidized.

By the end of 1980s, pursuant to the Act of 20 September 1984 on property and personal insurance, the mandatory insurance covered:

- (1) buildings – against fire, hurricane, flood and other force majeure incidents;
- (2) movable property related to the management of an agricultural holding, as well as other property - against fire, hurricane, flood and other force majeure incidents;
- (3) cereals crops, root crops and fodder plants – against hailstorm, fire, flood and flooding due to excessive precipitation;
- (4) civil liability of farmers for damages incurred in relation to the management of an individual agricultural holding and the damages done to private life.

In addition, until 1 July 1989 the mandatory insurance against death and emergency slaughter covered horses and cattle in the age of usefulness for production and swine, apart from piglets.

The tariffs of premiums for statutory insurance and the rules governing their payments were set forth by the Minister of Finance.

2. The market reforms which Poland has undergone since the political breakthrough of 1989/1990 destroyed the system. The implementation of the Act of 28 July 1990 on insurance activity provided the opportunity to conduct insurance activities in the conditions of free market economy and competition. At the same time numerous types of mandatory insurance, including mandatory insurance for agricultural crops, were abandoned.

Since 1990 the Act¹ has covered plant and animal production with voluntary insurance and at the same time has imposed an obligation on farm holders to conclude insurance contracts:

- (1) **on account of owning an agricultural holding** (farmers' civil liability insurance) – for the period of 12 months while the obligation to conclude such a contract occurs on the day of becoming a farm holder. Civil liability insurance of farmers consists in the civil liability of the farmer and any person who while working on the farm during the period covered by insurance protection caused damage in relation to the agricultural holding held by the farmer;
- (2) **buildings which are a part of an agricultural holding, against fire and other force majeure incidents** - for the period of 12 months, while the insurance obligation occurs on the day of covering the building with a roof.

Therefore, no new system was established to replace the mandatory system of agricultural property insurance, while the risk of management was increasing. It deprived the farmers of the system protection against the damages caused by force majeure incidents for many years.

As the problems grew, the market and quasi-market systems and an institution of insurance against force majeure incidents began to appear and develop.

By mid last year, farmers, with few exceptions, failed to apply insurance protection, and made their production and financial situation wholly subject to the risk of damages and disasters. The owners of agricultural holdings in the majority are not particularly affluent and the natural disasters pose the greatest threat to the poorest farmers. The annual damages are reflected in the conditions of farming for several years. The consequences of the necessary compensation of part of the damages are often charged also to the state budget. It may be said that only around 5% of agricultural holdings were covered by fragmentary insurance against the consequences of damages caused by force majeure incidents on market conditions in recent years.

¹ Act on mandatory insurance, Insurance Guarantee Fund and Polish Motor Insurers Bureau.

Property insurance in agriculture in 2004-2005 is characterised by the following factors

(in EUR million*)

Specification	2004	2005	$\frac{2005 \times 100}{2004}$
Total gross premium collection	88.5	92.2	104.8
including:			
- civil liability of farmers	8.3	9.0	108.8
- mandatory insurance of buildings	70.6	73.2	103.6
- voluntary insurance of crops and livestock			
Total compensation paid	9.6	10.7	110.9
including:	34.8	35.37	101.4
- civil liability of farmers			
- mandatory insurance of buildings	3.8	3.8	102.0
- voluntary insurance of crops and livestock	25.4	24.4	96.1
% compensation paid to gross premium ratio	5.7	7.1	125.1
	9.8	9.5	x

Source: Analysis of production and economic situation in agriculture and food economy in 2005, IERiGZ-PIB, Warsaw, 2006.

* according to EUR 1 = PLN 4 exchange rate

Therefore, it was necessary to support the farmers who suffered damages due to force majeure incidents with public funds. In accordance with the provisions in force laying down the principles of granting public aid to agricultural holdings – as part of the list of public aid forms in agriculture, submitted to the European Commission – in cases of unforeseen disasters, the affected farmers may apply for:

- preferential loans for reestablishment of production in relation to flood, drought, hailstorm, fire, heavy rain, hurricane, landslides and a plague of rodents;
- agricultural tax reliefs and real estate tax reliefs;
- reliefs and remissions in payment of dues on account of premiums and interests concerning farmers' social insurance;
- short-term financial aid to the amount depending on the state budget standing and the scope of the disaster;
- social assistance from the gmina administration.

According to official statistics², over 922,000 agricultural holdings were affected by drought, flood, hurricane, hailstorm, frost, heavy rain and landslides this year and the damages in those holdings were estimated at around 8.7 million ha and over EUR 1.5 billion. In fact, many more agricultural holdings suffered damages as a result of natural disasters, since the abovementioned data concern only those holdings which declared interest in applying for preferential loans concerning disasters and which had their damages assessed by the official commissions.

In recent years, around EUR 25 million a year were allocated from the state budget for the average annual subsidies to the above loans.

Between 2001 and 2006 the total expenditure for subsidies to the interest on loans for reestablishment of agricultural production in agricultural holdings and special sectors of agricultural production after natural disasters amounted to approximately EUR 140 million.

However, the access to the abovementioned forms of aid was limited due to:

- the necessity to be recognised creditworthy - in the case of applying for loans for reestablishment of agricultural production after a disaster, with subsidies to interest from the resources of the Agency for Restructuring and Modernisation of Agriculture;
- possibility to finance the farmers' entitlements to agricultural tax remissions or relief and other tax reliefs by gminas;
- strict income criterion applicable while farmers apply for social aid granted by the Gmina Social Welfare Centres;
- state budget capacity for short-term aid provided to the affected agricultural holdings.

The problem of mitigating the risk of management in the Polish agriculture is thus solved on the scale and in the forms which are far from needs and market solutions (or rather quasi-market solutions) applied throughout the world. It alleviates the problem of market losses but it does not create relatively stable conditions for risk management. The applied solutions alleviate the consequences and transfer them in

² Ordinance of the Council of Ministers of 30 January 1996 on detailed directions of activities of the Agency for Restructuring and Modernisation of Agriculture and the methods of their implementation (Dz.U. No 16, item 82, as amended)

time, mainly to the burden of farmers and to a certain extent also the public expenditure of the state and local governments (local tax reliefs).

It is not possible to quickly build the voluntary system, basing on solutions typical for the European Union Member States or the USA, in Poland. The mutual insurance societies, which could fulfil functions of mutual assistance and constitute an important element of the system, were not established. Maintenance and modernisation of the voluntary system will not change the situation radically, since the capacities of agriculture, even with the support of contributions from the state budget, will prevent its spread.

Therefore, it is necessary to return to the mandatory system, but with considerable elements of state intervention, in accordance with the rule that such intervention is the cheapest form of support to agriculture. In view of the integration and the future pan-European system, the concept of parallel private or quasi-private systems of voluntary insurance, including insurance addressed to special sectors of agriculture, should not be fully abandoned. In the long-term it would facilitate harmonisation of the Polish system with similar EU systems as the cost-effectiveness and profitability of Polish agriculture will increase.

Such a solution has already been initiated in the Act³ currently in force. The implementation of the provisions of this Act is to encourage farmers to conclude insurance contracts, as farmers, in view of the necessity to allocate resources for modernisation, conclude crops and farmed animals' insurance contracts to a very limited extent.

By the end of 2005 insurance protection in rural areas did not cover over 90% of basic plant and animal production.

The provisions of the Act allowed for the premiums collected on account of concluding insurance contracts covering the following crops and farmed animals to be covered by the state budget subsidies:

- (1) agricultural crops: cereals, maize, rape, turnip rape, potatoes, sugar beet,
- (2) farmed animals: cattle, horses, sheep, goats, pigs.

³ Act of 7 July 2005 on subsidies to insurance of agricultural crops and farm animals (Dz.U No 150, item 1249, of 2006, No 120, item 825).

The scope of insurance in agriculture covered basic agricultural crops in Poland and most important farmed animal species, which constitute over 58% of the total commodity value of agricultural production. Insurance of only basic directions of production allows for basic insurance protection for farmers and simultaneously should have an impact on the reduction of state budget subsidies to insurance premiums.

The system of subsidised insurance protects against damages resulting from the following force majeure incidents:

- *in plant production*: fire, hurricane, flood, torrential rain, hail, lightning, explosion, landslide, avalanche, drought, results of overwintering or spring frost;
- *in animal production*: fire, hurricane, flood, torrential rain, hail, lightning, explosion, landslide, avalanche, emergency slaughter.

The subsidies to insurance premiums are provided to insurance undertakings on the basis of contracts concluded with those undertakings by the minister competent for agriculture. The contracts set forth crops and animals insurance conditions, amount of tariff rates, procedure and dates of submission and settlement of resources for subsidies, conditions of their reimbursement if they were used at variance with their intended purpose, undue or excessive collection and the procedure for the control of subsidies and insurance contract implementation. Farmers who buy a policy pay premiums reduced by the amount of subsidy from the state budget, with the reservation that the share of the state budget in insurance premiums in the case of insurance of plant production is up to 40% of the premium, and in the case of animal production - up to 50% of the premium, and the tariffs of the crops insurance do not exceed 3.5% of the amount of insurance and tariffs of animal insurance – 0.5%. The maximum amount of subsidies to premiums on account of insurance of crops and farmed animals is determined each year by the Council of Ministers by way of an ordinance, taking into account the area of crops and number of animals to be covered by the insurance and the premises of the Budget Act.

The current system of subsidising crops and animals insurance premiums has been granted the notification of the European Commission. According to the Community Guidelines for State Aid in the Agriculture Sector (2000/C 28/02), aid for agricultural holdings in the form of aid towards the payment of insurance premiums is considered acceptable.

Taking into account new rules on granting state aid in agriculture which will enter into force in the European Union Member States, a draft amendment to the Act on subsidies to agricultural crops and farmed animals was drawn up which proposed the solutions encouraging insurance undertakings to conclude insurance contracts with agricultural producers, including first of all the increase of subsidies to premiums while insuring crops and introduction of the possibility of state budget share in reinsurance of insurance of crops against the risk of damages caused by drought. In addition, it is proposed that agricultural producers who receive direct payments had to insure the crops specified in the Act against the risk of flood, drought, bad overwintering or late frost.

Due to reluctance of insurance undertakings to sell insurance policies with respect to plant production against the effect of drought, the establishment of the Agricultural Crops Insurance Fund was proposed the proceeds of which are to include the payments from a part of the premiums collected by insurance undertakings on account of the crops insurance contracts concluded with agricultural producers and special purpose subsidies from the state budget, bank interest and other revenue. The resources of the Fund will be allocated for payments of compensations to agricultural producers in the case of drought to the amount specified in contracts concluded by insurance undertakings in the scope of reinsurance of this risk by the Fund. Reinsurance may also cover the mandatory crops insurance contracts in respect of which the subsidies to insurance premiums from budget resources are not granted, provided that a given insurance undertaking will submit a relevant application in this regard to the reinsurer managing the Fund prior to the conclusion of the first such contract.

The amended Act is to enter into force on 1 January 2007, except for provisions concerning the mandatory insurance of crops which will become effective on 1 July 2008.

Since the national state aid will be increasingly strictly controlled within the EU system, Poland, as well as other states, has to look for new forms of protecting farmers from the increasing consequences of damages caused by force majeure incidents.

Insurance of damages caused by force majeure incidents as an EU problem and an element of CAP.

Poland believes that in view of the growing problem of damages caused by force majeure incidents in the whole EU cannot be properly and efficiently solved on the scale of individual states.

The variability of risks on the European continent suggest seeking a common system, common insurance, as an element of CAP and the measures of the EU funds, in particular EAFRD. The reduction of subsidies to agriculture in the EU should mean the support for general economic conditions of farming within the framework of the rural development policy.

Poland supports the search for concepts, including attempts made by various Community institutions and bodies.

In order to proceed more efficiently within the European Union bodies on the European solutions concerning the creation of an European model of agricultural solutions, at the meeting of agriculture ministers from the European Union Member States in September Polish Minister of Agriculture and Rural Development presented a solution of the problem of compensation of damages in agriculture which occurred due to risks which are difficult to insure (particularly the risk of drought).

Annex 1

Key legal regulations concerning the conditions and rules of undertaking and conducting the activities in the field of property and personal insurance:

1. Ordinance of the President of the Republic of Poland of 27 May 1927 on compulsory insurance against fire and on the Common Mutual Insurance Undertaking (Dz.U. R.P. of 1933, No 3, item 23, as amended);
2. Ordinance of the President of the Republic of Poland of 24 October 1934 on insurance mediation (Dz.U. R.P. No 96, item 864);
3. Decree of 3 January 1947 on regulating material and personal insurance (Dz.U. R.P. No 5, item 23);
4. Decree of 3 January 1947 on Common Mutual Insurance Undertaking (Dz.U. R.P. No 19, item 72);
5. Act of 28 March 1952 on state insurance (Dz.U. No 20, item 130, of 1995, No 18, item 108);
6. Act of 2 December 1958 on property and personal insurance (Dz.U. No 72, item 357, as amended);
7. Act of 20 September 1984 on property and personal insurance (Dz.U. No 45, item 242, of 1989, No 30, item 160);
8. Act of 28 July 1990 on insurance activities (Dz.U. of 1996, No 11, item 62, as amended);
9. Act of 22 May 2003 on mandatory insurance, Insurance Guarantee Fund and Polish Motor Insurers Bureau (Dz.U. No 124, item 1152, as amended);
10. Act of 7 July 2005 on subsidies to insurance of agricultural crops and farm animals (Dz.U. No 150, item 1249, as amended).

