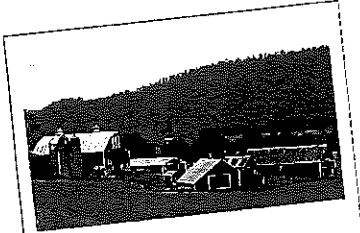


9/2/14
08/27/2014



Dairy Subtitle of the 2014 Agricultural Act

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We Made It!

Congress didn't make it easy, but on February 7th, President Obama signed the Agricultural Act of 2014 into law.

Things that Go Away

with the new farm bill

- Repeals the dairy export incentive program
- Repeals the dairy product price support program
- Repeals the MILC program after the margin protection program is operational
 - MILC has paid significant dollars to producers
 - MILC was an easy program in which to participate
 - Picking correct start month was probably the hardest part for large farms
 - Larger farms were not a fan of the program

U.S. weak dollar, more affordable
butter, nonfat dry milk, held until prices rebounded

Things that Stay

- Dairy Price Support Program (the old one—permanent legislation—of "Dairy Cliff" fame)
- Extends the dairy forward pricing program
- Livestock Gross Margin for Dairy
- Language that would allow the formation of a California Federal Milk Marketing Order with consideration of their quota program.

Things that Are New

- Creates a margin protection program (MPP)
 - Run by the Farm Service Agency
 - Farms can choose the MPP or LGM-D, but cannot use both *(we don't know if this can be an annual decision or a one-time decision)* *
- Creates a dairy product donation program - - -

MPP is similar to MILC

permanent decision, once enrolled

-> Gov't would purchase perishable dairy products + donate to food shelves. No storing products

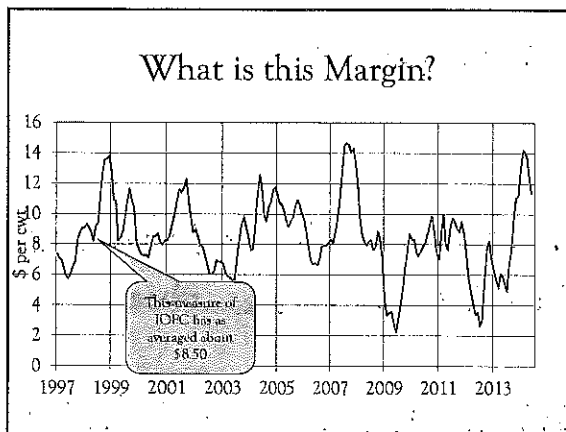
What is this Margin?

- All Milk Price less Feed Cost
 - The average cost of feed for a dairy operation required to produce a cwt of milk, determined in accordance with the following formula:

$$[1.0728 \times \$ \text{ corn/bu}] + [0.00735 \times \$ \text{ SBM/ton}] + [0.0137 \times \$ \text{ alfalfa hay/ton}]$$
 - Milk, corn and alfalfa prices reported by NASS in Agricultural Prices; soybean meal price is Central Illinois, USDA/AMS
 - Formula was developed by NMPF and used in the Dairy Security Act. Meant to feed cow at average production for 100 lbs of milk with complement of youngstock, dry cows and sick animals. Values reduced to 90% of full needs by Senate.

- Calculated for a cow producing 23,000 lbs/yr + other youngstock dry cows

- Senate reduced to 90% or 90lb/d milk



At \$4 margin it is considered catastrophic with no cost other than \$100/yr. At \$8 there is some pay out but with costs

What is this Margin?

- The margin values will be averaged in two-month pairs of Jan-Feb, Mar-Apr, May-Jun, Jul-Aug, Sep-Oct, Nov-Dec
- The margin level will determine indemnity payments
- This is a national measure of dairy farm well-being—your actual mileage will vary.

Annual Decision

- The MPP is an insurance product—you pay a premium and you will receive an indemnity payment if due
- You already have a production history
 - Highest annual production in 2011, 2012 or 2013
 - Your production history will be increased by national average rate of growth in milk production
- Annual choice of coverage percentage between 25% and 90% in 5% increments
- Annual choice of coverage level between \$4 and \$8 in 50¢ increments

This year - Can enroll now until Nov 28
 Normal 1st business day July until last business day September

x Each year ~~we~~ can change the level of coverage

x Can have reduced herd but payments up to prab herd production

Premium Rates

- Premiums at 2 rate levels: first 4 million pounds and above 4 million pounds
- Premiums increase in cost as you increase margin level.
- Much more expensive above \$6.50
- Also a \$100 annual fee

Margin Level	First 4 million pounds (\$ per cwt.)	Above 4 million pounds
\$4.00	\$0.000	\$0.000
\$4.50	\$0.010	\$0.020
\$5.00	\$0.025	\$0.040
\$5.50	\$0.040	\$0.100
\$6.00	\$0.055	\$0.155
\$6.50	\$0.090	\$0.290
\$7.00	\$0.217	\$0.830
\$7.50	\$0.300	\$1.060
\$8.00	\$0.475	\$1.360

* In 2014 and 2015 the premium rates for the first 4 million pounds will be reduced by 25 percent at all levels except at the \$8.00 level. A producer will also pay \$100 annually in administrative fees.

Cost of PH coverage

Feb 1st - pay 25% of ^{premiums} ~~premiums~~

June 1st - balance due

* FSA will take as ^{much} ~~many~~ out of payments.

Payments could be reduced due to gov't sequestration

\$0.54 increase for \$0.50 coverage

Premium Rates

- Premium rates are fixed over the life of the farm bill
- Premium rates are heavily subsidized

Coverage Level	First 4 M lbs PH	After 4 M lbs PH
\$4.00	\$0.000	\$0.000
\$4.50	\$0.010	\$0.020
\$5.00	\$0.025	\$0.040
\$5.50	\$0.040	\$0.100
\$6.00	\$0.055	\$0.155
\$6.50	\$0.090	\$0.290
\$7.00	\$0.217	\$0.830
\$7.50	\$0.300	\$1.060
\$8.00	\$0.475	\$1.360

Let's Look Back in Time

2005

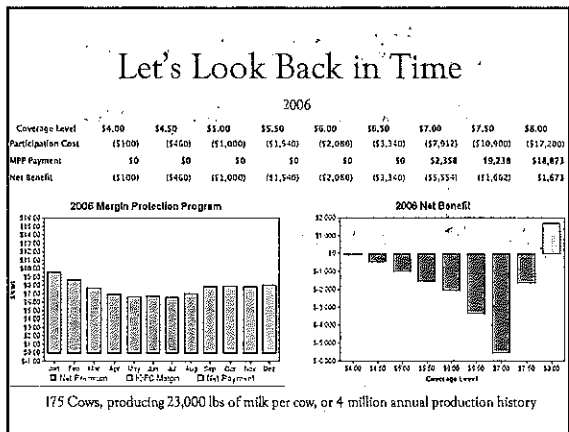
Coverage Level*	\$4.00	\$4.50	\$5.00	\$5.50	\$6.00	\$6.50	\$7.00	\$7.50	\$8.00
Participation Cost	(\$100)	(\$450)	(\$1,000)	(\$1,140)	(\$2,080)	(\$2,140)	(\$7,912)	(\$10,900)	(\$17,200)
MPP Payment	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0	\$0
Net Benefit	(\$100)	(\$450)	(\$1,000)	(\$1,140)	(\$2,080)	(\$2,140)	(\$7,912)	(\$10,900)	(\$17,200)

2005 Margin Protection Program

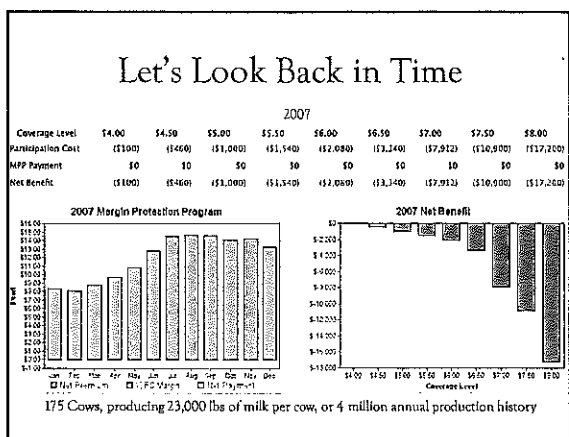
2005 Net Benefit

175 Cows, producing 23,000 lbs of milk per cow, or 4 million annual production history

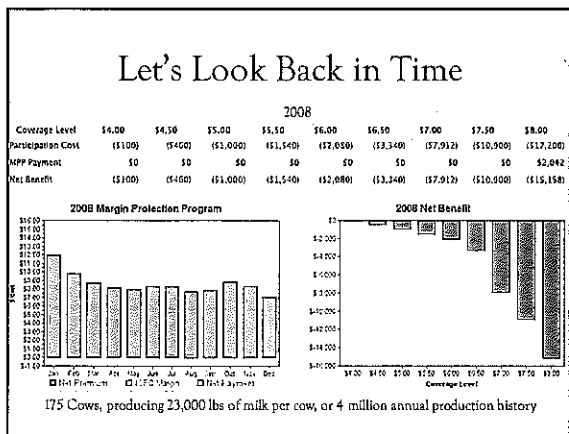
\$4.00 would have been optimal coverage in 2005



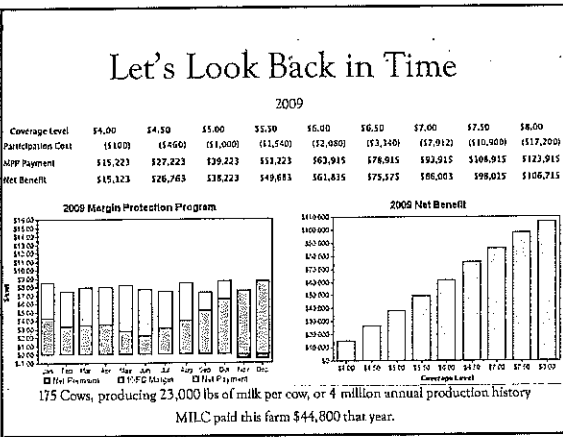
2006 → \$8.00 level



\$4 coverage 2007

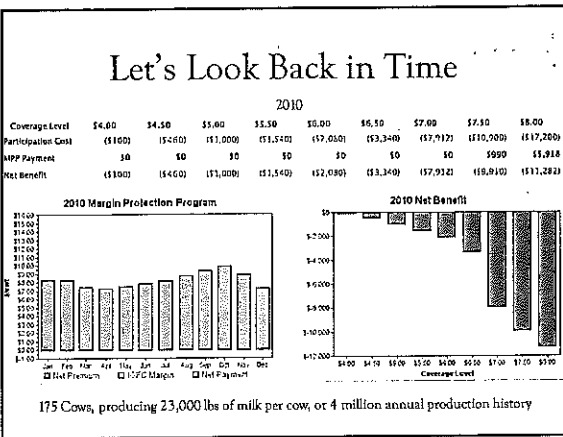


\$4 coverage would have been optimal

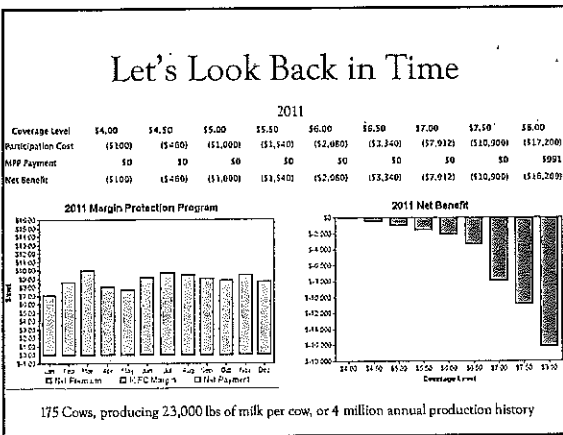


\$4 still \$15,000+ in payments
\$8 - over \$100,000 in payments

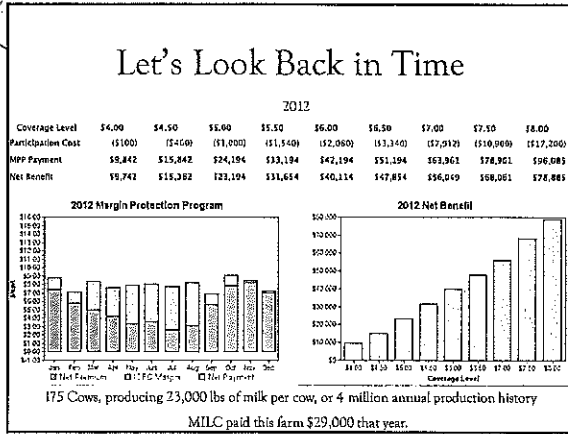
Milk price problem



\$4

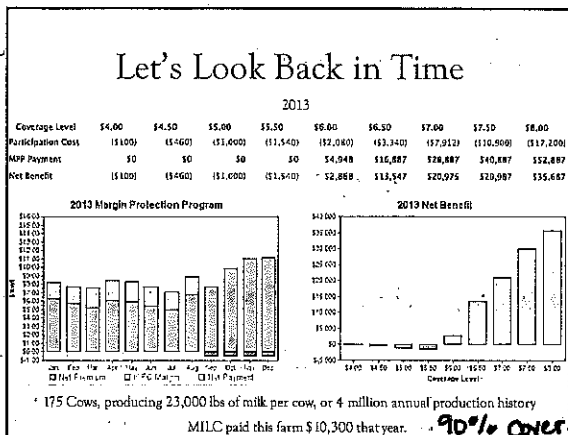


\$4



\$8.00

* Ave milk price, feed price
problem. Producers that purchase
all feeds were affected the most



\$8.00

If We Picked the Optimal Strategy

Year	Optimal Strategy	Optimal Outcome
2005	\$4.00	-\$100
2006	\$8.00	\$1,673
2007	\$4.00	-\$100
2008	\$4.00	-\$100
2009	\$8.00	\$106,715
2010	\$4.00	-\$100
2011	\$4.00	-\$100
2012	\$8.00	\$78,885
2013	\$8.00	\$35,687
2014	\$4.00	-\$100
Total		\$224,137
per cow		\$128.08
per cwt		\$0.56

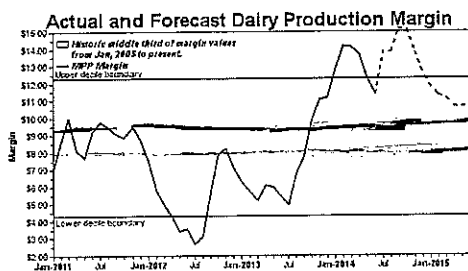
For small producers it would
have been all or nothing

What Do We Learn?



- Like my daughter, one foot is on the brake and one on the gas... and one foot or the other is all the way down.
- Problem is, we don't know with certainty what the future will be.

We Aren't Clueless



dairymarkets.org

fsa.usda.gov

Decision Tools - Forecast usually have market direction correct but underestimate the extreme highs + lows



If We Picked Advanced Strategy

Year	Advance Strategy	Advance Outcome
2005	\$4.00	-\$100
2006	\$4.00	-\$100
2007	\$6.00	-\$2,080
2008	\$6.00	-\$2,080
2009	\$8.00	\$106,715
2010	\$4.00	-\$100
2011	\$8.00	-\$16,209
2012	\$6.50	\$48,004
2013	\$6.50	\$14,930
2014	\$4.00	-\$100
Total		\$148,880
per cow		\$85.07
per cwt		\$0.37

vs. hindsight optimal
 224,000
 128.00

Dairy Product Donation Program

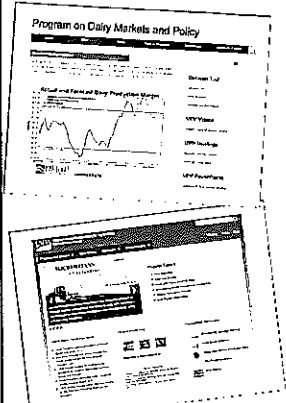
- Must be operational no later than 120 days after the margin program begins
- When the margin is less than \$4.00 for the two preceding months, this feature becomes operational
- Secretary purchases dairy products at prevailing market prices and distributes to public and private nonprofits assisting low-income households. Cannot hold/store purchases.
- This program suspended:
 - After three months of operation
 - Margins move above \$4.00
 - Margins between \$3.00 & \$4.00 AND U.S. prices exceed world prices by more than 5%
 - Margins less than \$3.00 AND U.S. prices exceed world prices by more than 7%
- Program will shorten low margin periods but cost more than paying indemnities

Observations...

- Program will support larger dairies much better than MILC did
- Program will require some decisions and some "skin in the game"
- It will reduce income risk
- Less risk will produce more milk in the long-run

Conclusions...

- Need to think about:
 - Your risk-bearing ability (*high versus low leverage*)
 - Your risk preferences (*love the thrill, or can't sleep at night*)
 - Am I a small farm or a larger farm (*cost of premiums makes a difference*)
- Do you need other forms of coverage:
 - LGM-Dairy vs MPP-Dairy
 - MPP-Dairy plus forward contracts or futures
- MPP-Dairy will be a very helpful tool, but it's no substitute for good management



Program on Dairy Markets and Policy

For More Information
<http://DairyMarkets.org>
<http://FSA.USDA.gov>

LGM-Dairy is an insurance product. MPP-Dairy is insurance-like

- * premiums change every year
- * enrollment available every month
- * only certain amount of subsidies available - once out it is gone.

MPP-Dairy. could get payment every 2 mo.