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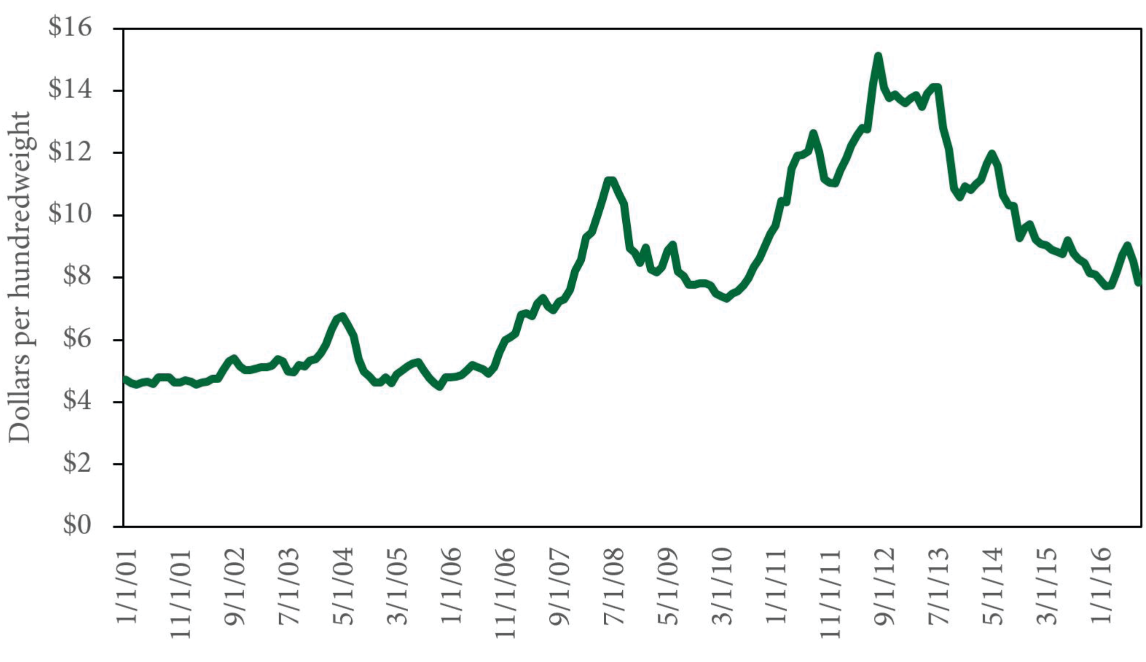
Should the Dairy Margin Protection Program be Replaced with Target Milk Price Protection or Revenue Insurance?

BACKGROUND

The Dairy Margin Protection Program (MPP) offers margin insurance to dairy producers on the difference between the national average all milk price and the national average prices for corn and alfalfa hay, and the Decatur, Illinois soybean meal price. Each year, dairy farmers may select an MPP margin and a coverage percentage of their milk production history to insure. Coverage levels range from $4.00 to $8.00 per hundredweight (cwt) and farmers may cover 25 percent to 90 percent of their milk production history.

Following several consecutive years of bumper crops in the U.S. and around the world, prices for livestock feed ingredients have fallen by nearly 50 percent. The parallel shift in both milk prices and livestock feed costs resulted in the MPP margin only falling below the maximum MPP level of coverage in the first half of 2015 and 2016 despite milk price declines of nearly 40 percent.

MPP Dairy Feed Costs in Dollars per Hundredweight



ISSUE

In a low feed cost environment, revenue variability to dairy farmers is very sensitive to swings in the milk price. MPP is designed to cover the difference between milk prices and fee costs and is therefore less responsive when both milk prices and feed prices decline.

OPTION #1

Replace MPP with a Target Milk Price Program. Similar to the Price Loss Coverage program and the recently repealed Milk Income Loss Contract program, replace MPP with a target milk price program based on the U.S. all-milk price. Under such a program, producers could receive protection against milk price declines below a market-based average or the historical average. Since 2001, the U.S. all-milk price has averaged $16.61 per hundredweight. Additional protection above a minimum milk price could be purchased, similar to MPP supplemental coverage options.

OPTION #2

Develop an Actuarially-Sound Dairy Revenue Protection Program (Dairy-RP). A Dairy-RP insurance policy would be modeled after revenue-based crop insurance programs. The policy would offer insurance protection on the quarterly revenue risk on the dairy farm (milk price multiplied by milk production). Dairy farmers would choose a milk price on which to insure based on futures market prices and could cover a volume of milk production per cow reflective of their state's milk production (providing regional-based risk protection). Dairy farmers would then select what percentage of the revenue guarantee to protect (e.g., a 10 percent deductible). The total guarantee would be equal to the product of the milk price, milk production, and insurance coverage level. Indemnity payments would be triggered when price or production declines result in actual revenue below the guaranteed revenue. A numerical example is provided below:

Dairy – Revenue Protection Example	
	Lower Milk Price, Normal Yield
Class III Milk Futures Price	$18
Expected Quarterly Milk Production per Cow	5,000
Coverage Level (10% Deductible)	90%
Revenue Guarantee per Cow	$810
Final Class III Milk Price	$15
Actual Quarterly Milk Production per Cow	5,000
Actual Revenue	$750
Indemnity Payment per Cow (Guarantee Minus Actual)	$60
Number of Milking Cows	1,000
Dairy-RP Payment	$60,000