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## Should the Coverage Levels for the Margin Protection Program be Increased?

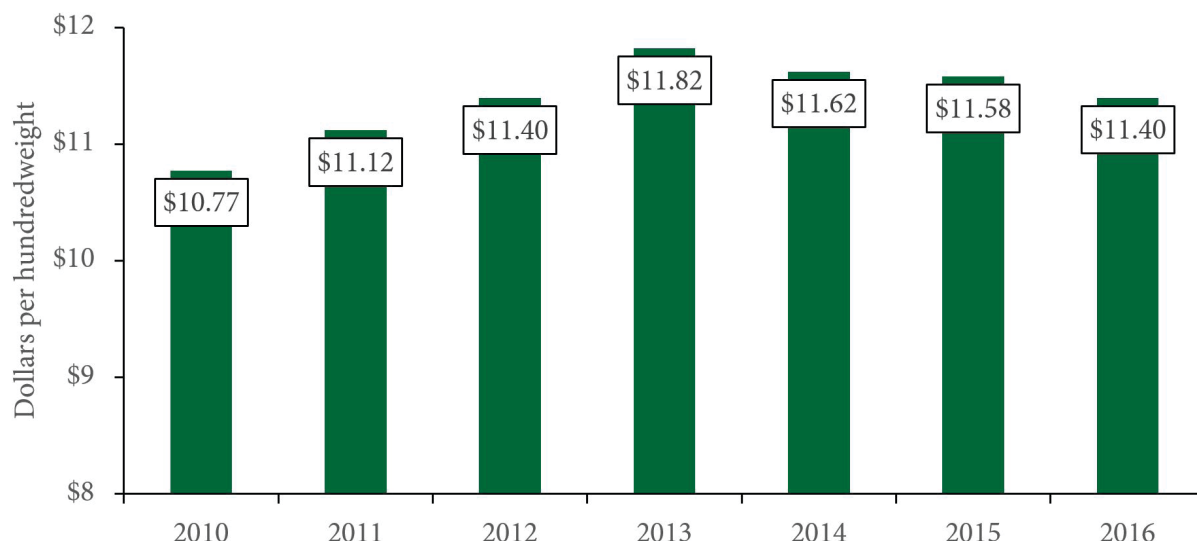
### BACKGROUND

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.

Since 2001, the MPP margin has averaged \$8.58 per hundredweight. Given this historical average, the MPP coverage levels of \$4.00 to \$8.00 allow farmers to protect as much as 93 percent ( $\$8.00 \div \$8.58 = 93\%$ ) of their historical average income-over-feed-cost margin. The non-feed portion of dairy farmers' operating costs that must be covered with the income-over-feed-costs includes veterinary care and medicine, bedding and litter, marketing, custom services, energy, repairs, interest, labor, capital recovery, land value, taxes, and general farm overhead. Based on USDA milk cost of production data, the U.S. average for these non-feed costs was \$11.40 per hundredweight in 2016. Since that is the U.S. average, a number of farmers' operating costs were below and above this estimate.

### Annual Average Non-Feed Dairy Costs of Production

Source: USDA ERS



### ISSUE

While milk prices have declined by nearly 40 percent since 2014, USDA data reveals that non-feed costs have declined only 4 percent from their highs of 2013. Due to slowly declining non-feed related expenses, MPP coverage levels could be modified to reflect certain non-feed costs.

## OPTION #1

Modify MPP coverage levels by increasing the levels above the current \$8.00 maximum. This would allow dairy producers the opportunity to purchase additional risk management support to help cover some of the non-feed costs of production. However, increasing the coverage level would allow farms to protect margins well above the historical average. For example, a \$10.00 MPP coverage corresponds to 117 percent ( $\$10.00 \div \$8.58 = 117\%$ ) of the historical average. A \$12.00 MPP coverage corresponds to 140 percent ( $\$12.00 \div \$8.58 = 140\%$ ) of the historical average.

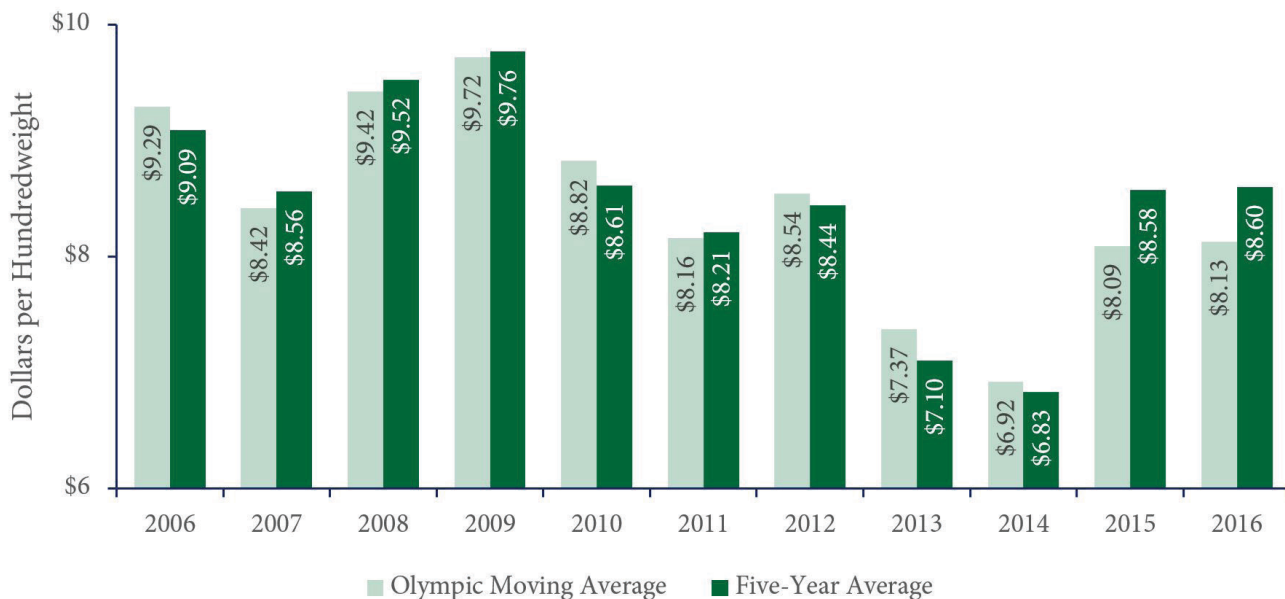
Due to the potential for higher MPP guarantees, the MPP margin formula may need to be reevaluated. For example, adding additional non-feed costs and keeping the MPP coverage levels unchanged would increase the frequency and magnitude of program payments. Alternatively, without altering the underlying MPP margin formula, increasing the MPP coverage levels would increase the frequency and magnitude of program payments. For more information on the MPP margin formula, see [Should the MPP Feed Ration be Increased by 10 Percent](#).

Additionally, without offsetting adjustments to the premium structure or amount of milk eligible for coverage, any modification to MPP designed to increase the frequency or magnitude of program payments will increase the cost of the program. This may necessitate adjusting the MPP premium levels – potentially using a method that is more actuarially sound. For more information on actuarially sound MPP premium rates see: [Should Dairy Margin Protection Program Rates be Adjusted](#).

## OPTION #2

Similar to the Agricultural Risk Coverage program, MPP coverage levels could be reset each year based on a five-year Olympic moving average or a simple five-year moving average. An Olympic moving average excludes the highest and lowest value when calculating the sample average. Providing flexibility to the MPP coverage levels would allow farmers to purchase more market oriented risk management protection.

### Moving Average MPP Margins



Following years with higher MPP margins levels, adjusting the MPP coverage level higher would provide risk protection as prices declined lower. This would provide an opportunity for farmers to better manage the lag between milk prices and non-feed operating costs. Following poor price environments, MPP protection would be lower (e.g. 2014).

Importantly, flexibility in the MPP coverage levels would require the program to adopt a more actuarially sound premium rating methodology rather than Congress setting the premium rate in statute for the life of the Farm Bill. Actuarially sound premiums with fixed subsidy percentages (i.e., variable rate coverage) may allow the program coverage options to be modified without raising the cost of the program.