September 1, 2016

FARM BUREAU® 2018 Farm Bill

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Should Dairy Margin Protection Program Rates be Adjusted?

BACKGROUND

Under the Dairy Margin Protection Program (MPP), producers pay premiums for coverage and must take an active role in selecting their coverage options each year. The basic $4.00 coverage option is provided to all farms enrolled in MPP and who pay the annual $100.00 administrative fee. For supplemental coverage above $4.00, farmers may purchase coverage from $4.50 to $8.00 per hundredweight in 50 cent increments on 25 to 90 percent of their base milk production history. Premiums are lower for the first four million pounds of milk covered (Tier 1) and increase for milk covered above four million pounds (Tier 2).

ISSUE

Premium rates are not actuarially sound, but instead are set by law and do not adjust to reflect changes in market conditions, prices or the risk environment.

MPP-Dairy Premiums and Administrative Fees

MPP-Dairy Coverage Level	Actual Tier 1 Premium (2016-18)	Actual Tier 2 Premium
Administrative Fee in Dollars	$100	
$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

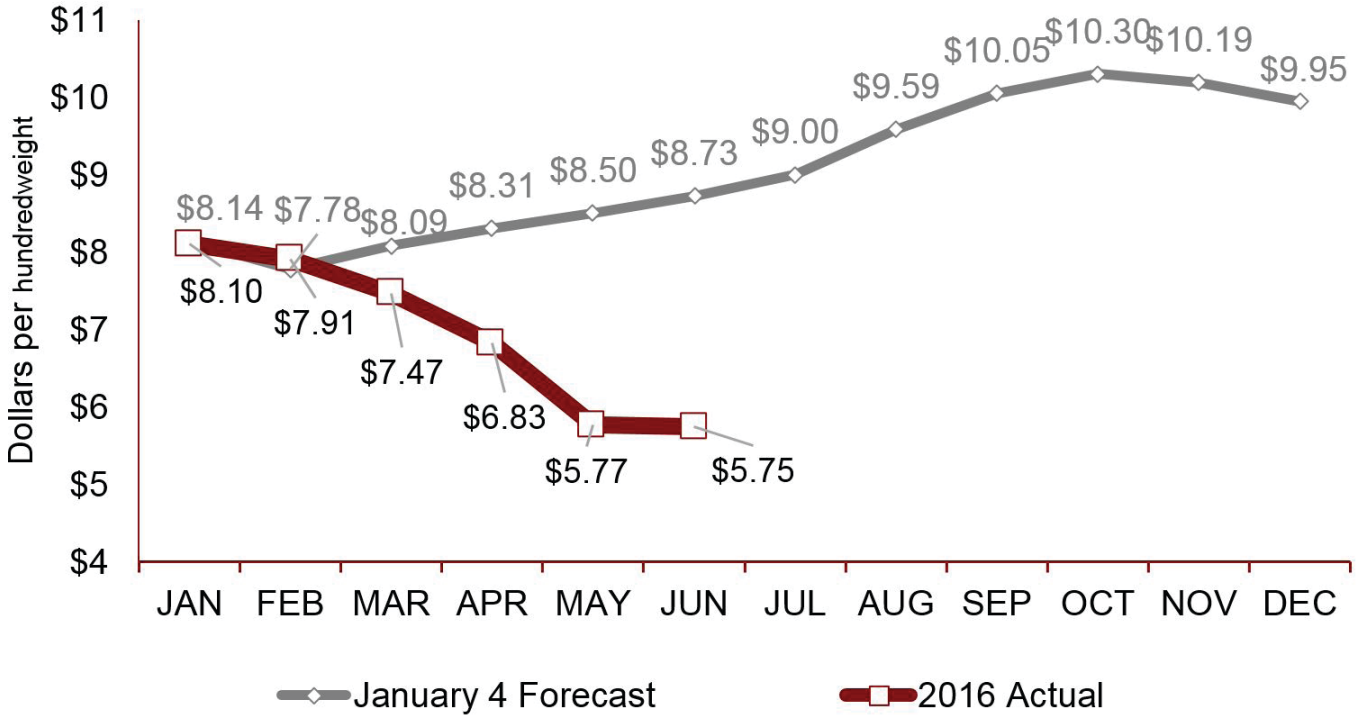
OPTION #1: USDA Resets MPP Premiums Annually

Provide administrative authority to USDA to set MPP premiums each year. This will allow USDA to set premium rates lower when forecasted MPP margins are above trigger levels, but may potentially result in higher premium rates when forecasted MPP margins are below trigger levels.

Futures market projections of milk and feed prices provide an estimate of potential program payments that might be useful to farmers in deciding which coverage level to select. For example, during the 2016 enrollment period futures markets indicated a low probability of triggering MPP. As a result, a majority of farmers evaluated the costs of participation against likely program payments and opted to enroll at the $4.00 catastrophic level. The $4 coverage level had the lowest costs of participation.

However, in June 2016, MPP margins fell to $5.75, their lowest levels since the program began. Many farmers were unprotected against this unforeseen margin decline. Providing USDA administrative authority to reset MPP premiums each year would allow the participation costs to align with the market conditions and risk environment. Using 2016 as an example, MPP premiums based on market conditions would have been lower during sign-up (as the forecasted margin was above MPP trigger levels) and would have made the costs and benefits of participation more even for dairy farmers.

USDA MPP Margin Forecast and 2016 Actual



OPTION #2: Lower MPP Premium Rates and Add Another Lower-Priced Tier

Reduce the HPO premium using a net farm income sliding scale or other forms of means testing. Increase the number of tiers from two to three to add an additional schedule of MPP premiums to assist small producers. For example, MPP premiums could be set lower for the first two million pounds of milk covered.

MPP premiums for all other tiers could also be reduced to make the program more affordable. For example, a premium discount of 25 percent was provided for the 2014 and 2015 calendar years for Tier 1 rates for all coverage levels except the $8 level.

OPTION #3: Actuarially Sound Premium Rates

Require the premium rate be set each year in an actuarially sound manner rather than setting the rates in law. This option would require USDA to estimate the probability of MPP triggering each year and then set premium rates according to the risk environment. After establishing the premium rates, fixed subsidies could be applied based on factors such as the amount of milk covered or the coverage level. Similar rate making procedures are used to establish crop insurance rates.

This differs from option 1 as the premiums rates would be determined using futures prices and mathematical models to determine the actuarially fair value.