By Kevin Hernandez, CPA

DOES THE MARGIN PROTECTION PROGRAM CAST ITS NET WIDE ENOUGH?

There has been a lot of talk about the Margin Protection Program (MPP) introduced in the new Farm Bill. The MPP replaces the Milk Income Loss Contract (MILC), Dairy Product Price Support and Dairy Export Incentive Program. These programs were considered mostly ineffective because they focused solely on prices and not costs. As most dairymen know, this logic is flawed. The industry has seen drastic volatility in the feed marketplace with break-even prices rocketing higher for most producers in the last 10 years. Is the MPP a solution or another so called “safety net” with one too many holes? Let’s take a look into it. I will let you decide for yourself.

What is the Margin Protection Program?

This risk management tool is meant to protect farm income over feed cost margins. The margin is determined monthly by the USDA using the national all-milk price minus the national average feed cost. Feed cost is based on a realistic feed ration to feed an entire dairy farm with 1,000 mature cows producing 69 pounds per day and an 80% replacement ratio (i.e. 800 replacement heifers). The margin calculation will average two consecutive months beginning January and February. In the first year of operation, coverage is based on the operation’s highest level of annual milk for 2011, 2012 and 2013. In subsequent years, annual adjustments to the producer’s production is based on the national average growth in overall U.S. milk production. In 5% increments, producers can protect 25-90% of their production. Margin protection will range $4.00 - $8.00/cwt. in $0.50 increments. Dairy operations will pay no premium for $4.00 margin coverage and up to $0.475/cwt. for $8.00 coverage on the first 4 million pounds and $1.36/cwt. for $8.00 margin coverage on production in excess of 4 million pounds.

What is the bright side of the MPP?

• For starters, it takes both feed cost and milk price into consideration, which is where the previous programs fell short. You cannot look at one without the other.

• It only costs $100 to enroll in free $4.00 margin coverage. That is market crash conditions, but the national average margins over the last 13 years have fluctuated from $2.25-$14.65/cwt. Had the program been in place during those years, participating producers would have received payouts for most months in 2009 and some in 2012. This would have included the free margin coverage of $4.00 and therefore recovering at least some cash deficits for those years.

• All dairies are able to participate. The MPP does not have the adjusted gross income limitations as the MILC program had, nor does it have a production limitation.

• The program allows producers to “test the waters.” Producers are able to “bounce in and bounce out” annually. Registering doesn’t lock a producer in for the life of the program. Also, you can choose to cover as little as 25% of production.

• It’s more accommodating to smaller dairies with a substantial discount for coverage on the first 4 million pounds.

• The premiums schedule is fixed for the life of the program, but a discount of 25% is planned for 2014 and 2015, except for the $8.00 level and only for marketing under 4 million pounds.

• The producers share the cost of the program with the government.

Where does it fall short?

• The national all-milk price and national feed costs do not correlate with some states. In particular, in California, milk price is closest to Class 4b. This is historically lower than the national milk price and feed costs in Calif. are historically higher than

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feed costs in other parts of the country. Therefore, many operators in states like Calif. will not be protecting "true margins" with the program.

• The MPP provides better coverage on a hundredweight basis to smaller dairies because the premiums are considerably more expensive for medium to large dairies with production over 4 million pounds.

• For larger operations, buying margin coverage for $7.00 and up would likely only pay off under market crash conditions like seen in 2009.

• The program has the potential to be very expensive under market crash conditions, which could make it controversial.

Overall, the consensus is that the program is a step in the right direction from past support systems. However, there are still plenty of unknowns yet to be addressed. For example, how far in advance must you sign-up for the desired coverage period? Will it be three or six months? Some critics believe six months is ideal so that there is no "adverse gaming," hence less ability to forecast margins over the coverage period. How long is enrollment? Will the program premiums be assigned from milk checks? These are just a few questions the policy makers will need to address before the program goes live. ❒

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