HOARD'S DAIRYMAN

New budget deal strengthens dairy's safety net

by Scott Brown

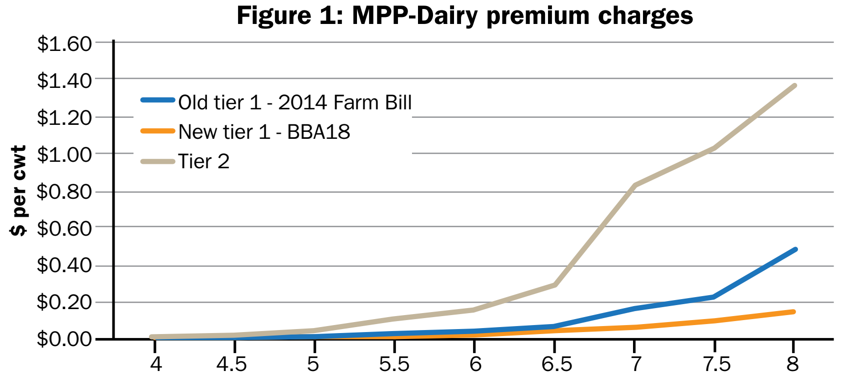
THE Bipartisan Budget Act of 2018 (BBA18) signed into law in early February included provisions that change how the dairy margin protection program (MPP-Dairy) operates for dairy farmers. The changes included in the BBA18 are meant to provide a better safety net for dairy producers than the original MPP-Dairy provisions passed in the 2014 Farm Bill.

What are the improvements?

Lower Tier 1 Premiums. One of the major changes under the new legislation is that premiums on the first tier of production history coverage are substantially lower. Premiums are now eliminated at the $4 through $5 coverage levels on the first tier of coverage.

Premiums also have been lowered on all remaining levels of coverage under the first tier. At the highest $8 coverage level, premiums have been reduced 70 percent compared to what was originally implemented under the 2014 Farm Bill. Figure 1 shows the old and new premium structures.

Figure 1: MPP-Dairy premium charges



Tier 1 coverage expands to 5 million pounds. Beyond reducing premiums on Tier 1 coverage, Tier 1 coverage is expanded to 5 million pounds from the original 4 million pounds contained in the 2014 Farm Bill. The additional 1 million pounds of Tier 1 coverage can prove important to those operations with more than 4 million pounds of production history. Under the 5 million-pound coverage cap, even a 20 million-pound production history operation (approximately 800 cows) could choose to cover 25 percent of its production history and qualify for the lower Tier 1 premiums.

Monthly payments. The new legislation also changes to a monthly calculation of the MPP-Dairy margin versus the bimonthly calculation set forth in the 2014 Farm Bill. This change will provide for a few more periods where producers may receive payments since sometimes averaging two months together negates the fact that one of the months fell below the trigger. It also will allow producers to receive payments more quickly after experiencing difficult financial months, as payments can be processed without waiting an additional month required by the bimonthly calculation.

In looking at historical data over the 2008 to 2017 period, a monthly payment scheme raises the frequency of a payment by 4.1 percent at the $8 coverage level. The lower the coverage level chosen, the smaller the effect of moving to a monthly payment triggers. For example, at a $5 coverage level, the frequency of a payment rises less than 1 percent from 2008 to 2017.

2018 MPP-Dairy sign-up reopened. Although the details will need to be provided by USDA before the exact timing is known, dairy producers will have an opportunity to re-examine their 2018 participation decision. Given current projections of the MPP-Dairy margin for 2018 that estimate MPP-Dairy margins below $8 for at least the first half of 2018, it seems likely that many will want to sign up at higher levels of coverage. This especially holds true on the Tier 1 production history given the likelihood of payments this year, coupled with the reduced Tier 1 premiums.

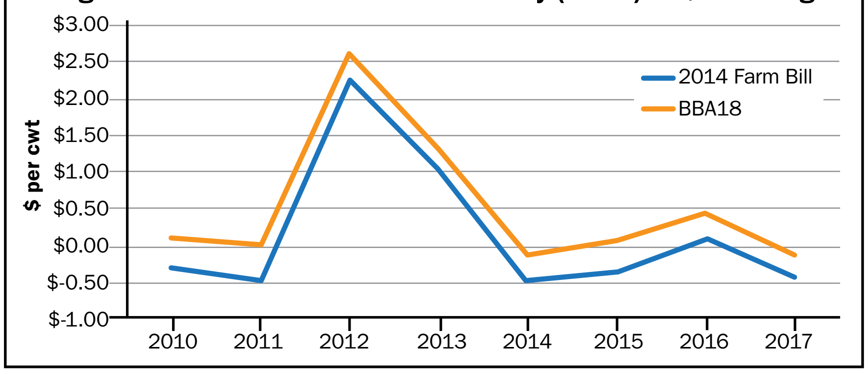
Other budget provisions. The BBA waives the annual $100 administrative fee for those operations that meet the designation as a beginning, limited resource, disadvantaged, or military veteran dairy producer. In addition, BBA18 removes the cap on livestock insurance programs like the Livestock Gross Margin (LGM) program for dairy.

What do these changes mean?

Producers who elect to sign up for higher Tier 1 coverage levels will benefit from the changes made in BBA18. Lower premium costs, slightly higher payment frequencies, and the ability to cover 5 million pounds of production history at Tier 1 premium rates lead to higher net benefits than under the 2014 Farm Bill.

Using the example of a producer signing up for $8 coverage during the 2010 to 2017 period, the average per hundredweight net benefit for covered production history was 51 cents per hundredweight compared to just 15 cents per hundredweight under the 2014 Farm Bill parameters. This simple example assumes a producer whose production history is at a level where all production history receives payment under either program. That is, a producer with 4 million pounds of production history or less.

Figure 2: Annual net benefit of MPP-Dairy (Tier 1) at $8 coverage



Meanwhile, Figure 2 shows that each and every year from 2010 to 2017 would have provided a higher net benefit for covered milk under the updated MPP-Dairy provisions. It also shows that there are many years in which signing up for $8 coverage would have resulted in a net financial loss, as premium payments, even at the greatly reduced premium rate, would be larger than any producer receipts from the program.

It is crucial to realize that though BBA18 is a financial improvement for producers who sign up for higher coverage levels, the program is still dependent upon producers making that choice. The safety net is only strengthened for those who choose to take advantage of what BBA18 offers.

The changed MPP-Dairy provisions contained in the BBA18 do not change anything that alter the likelihood of a payment beyond the change from a bimonthly to monthly payment scheme. There is no adjustment to the MPP-Dairy formulas feed coefficients or an increase in the coverage level that would raise the likelihood of triggering a payment.

It appears that BBA18 will allow more MPP-Dairy participation in 2018. That's because dairy producers can take advantage of knowing more about the 2018 margin situation and may in fact know when they sign up whether the program will make larger payments than they will pay in premiums.

In 2019 and beyond, producers will be back to having to make a decision before the market situation unfolds. That will shift the focus back to whether the changes in BBA18 provide a safety net that they will be willing to participate in even if they do not receive payments every year.

Large dairy producers, especially those with more than 20 million pounds of production history, will likely not notice much change in how they perceive the new MPP-Dairy features contained in the new legislation. The effects of uncapping the current LGM-Dairy spending cap may provide additional risk management help that producers need to survive in these volatile markets.

The industry must continue to assess risk management options for dairy producers that provide an adequate safety net yet stay within the federal budget allocation. BBA18 is a move toward a stronger safety net for participating producers. Only time will tell whether it enhances producer participation, though.

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