# Mechanics of the USDA Margin Insurance Proposed in the Farm Bill

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# A Different Form of Risk Protection Coming?

- Farm bill alternatives still being debated
- Dairy margin protection has been front and center
- Much discussion around the market stabilization component
- Margin protection is VERY different than other market-based risk management tools
- It is time for producers to think about their use of the program
  - How good of a risk reduction tool is it on your operation?
  - Can it be used with other market risk reduction tools?

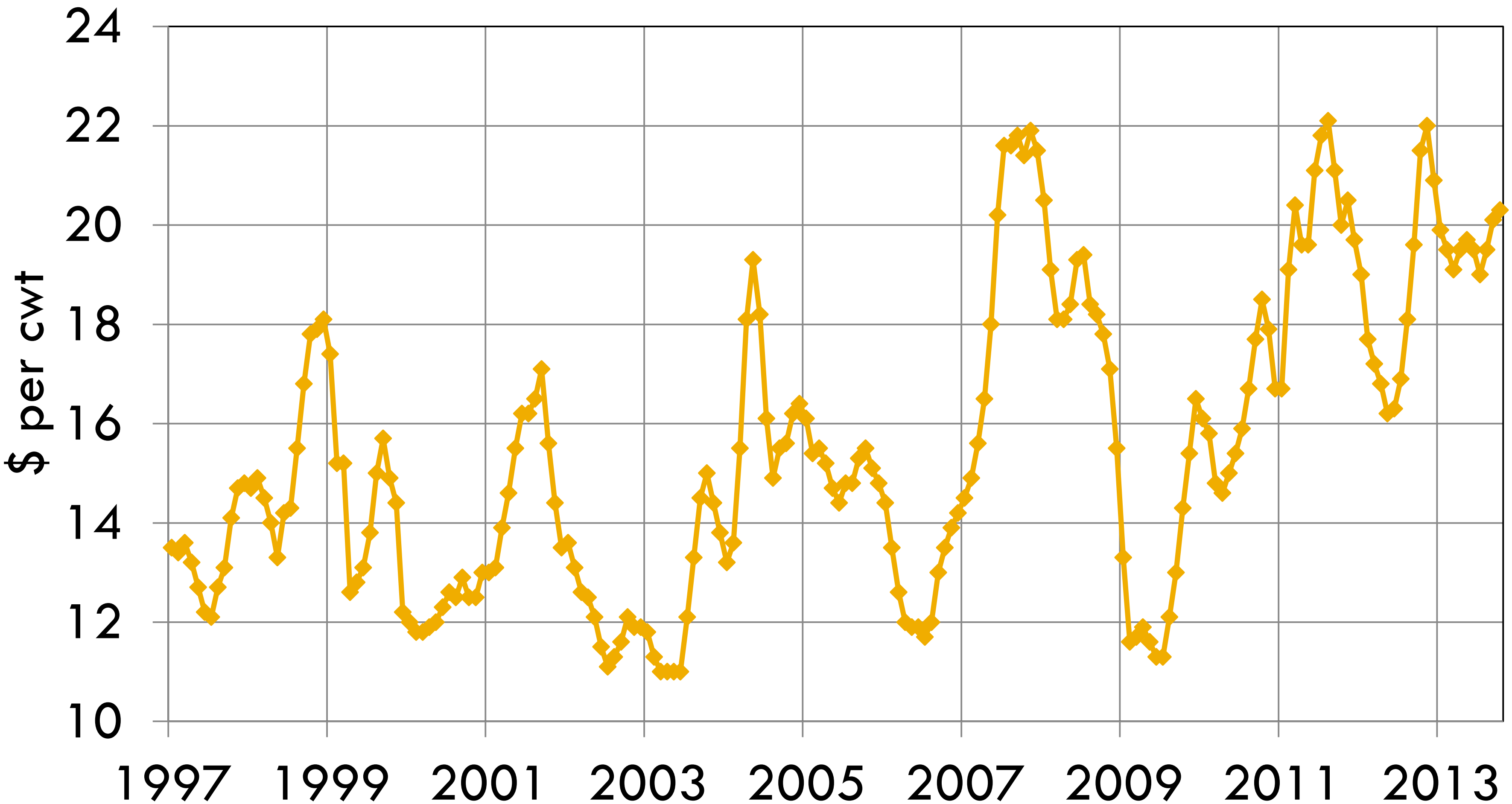
# Margin Protection (Milk Price Less Feed Costs) Has Been The Focus

- The combination of high feed costs and price volatility has led the discussion of margin protection
- Protecting margins instead of just milk prices helps on government outlays because milk prices and feed costs are correlated
- This margin is what producers have available to pay for all other costs besides feed costs
- There has been inflation in these other costs over time
- Producer response to margin risk reduction

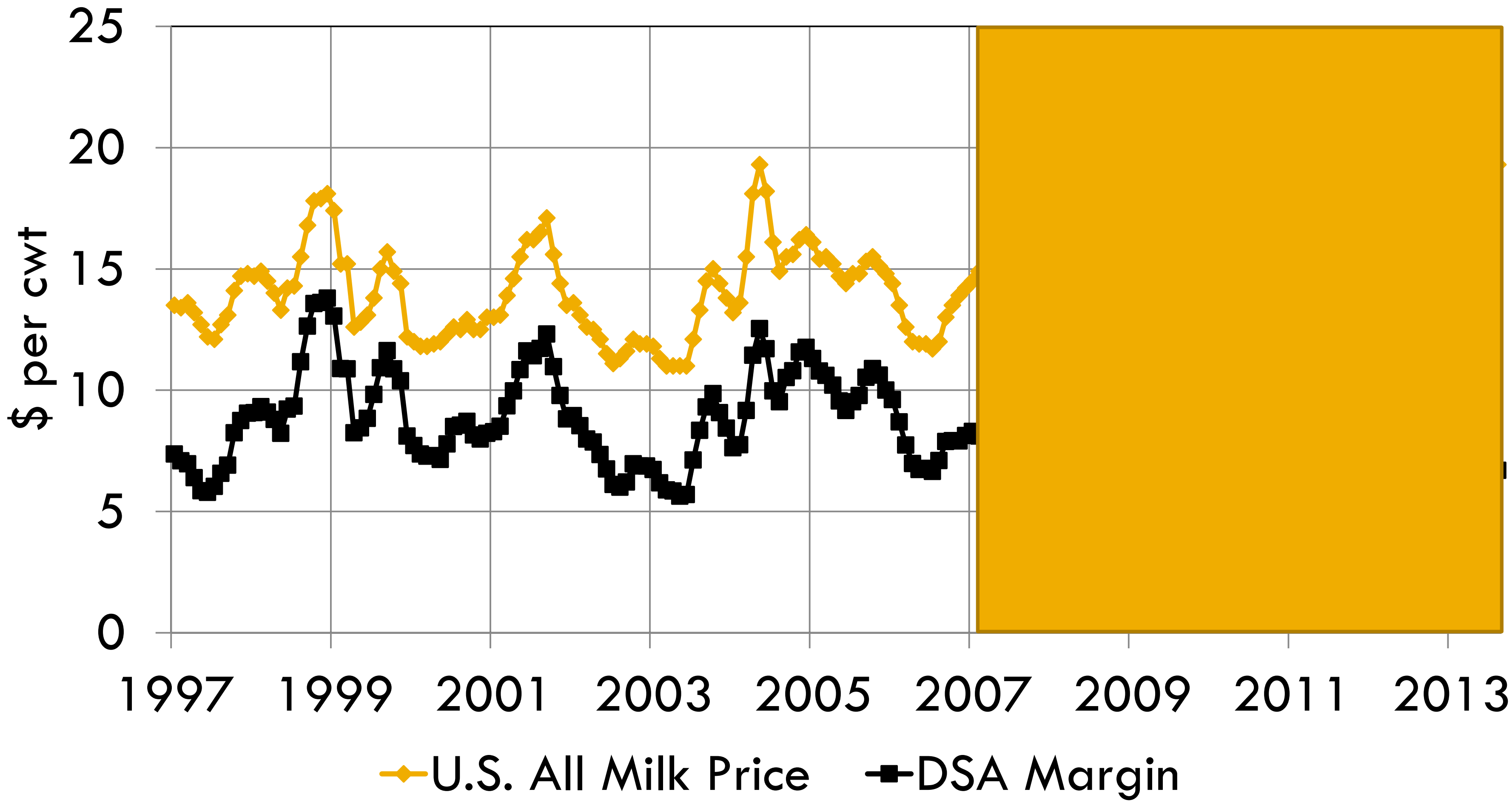
# National Program Margin Calculation

- **All Milk Price less Feed Cost**
  - The average cost of feed for a dairy operation required to produce a Cwt. Of milk, determined in accordance with the following formula: [1.0728 x price of corn/bu.] + [0.00735 x price of soybean meal/ton] + [0.0137 x price of alfalfa hay/ton].

# Monthly U.S. All Milk Prices



# Dairy Industry Facing Milk Price and Margin Volatility

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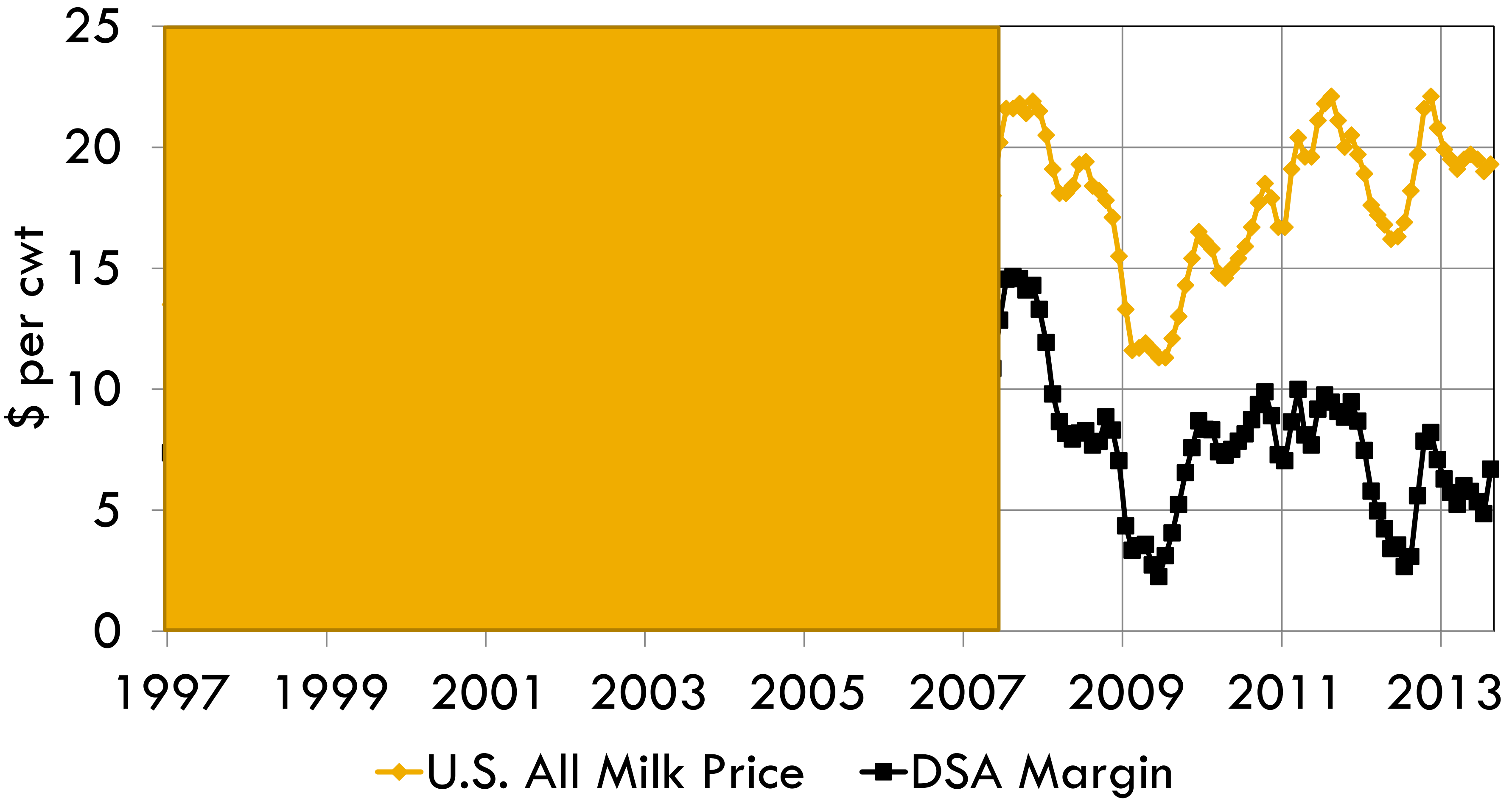


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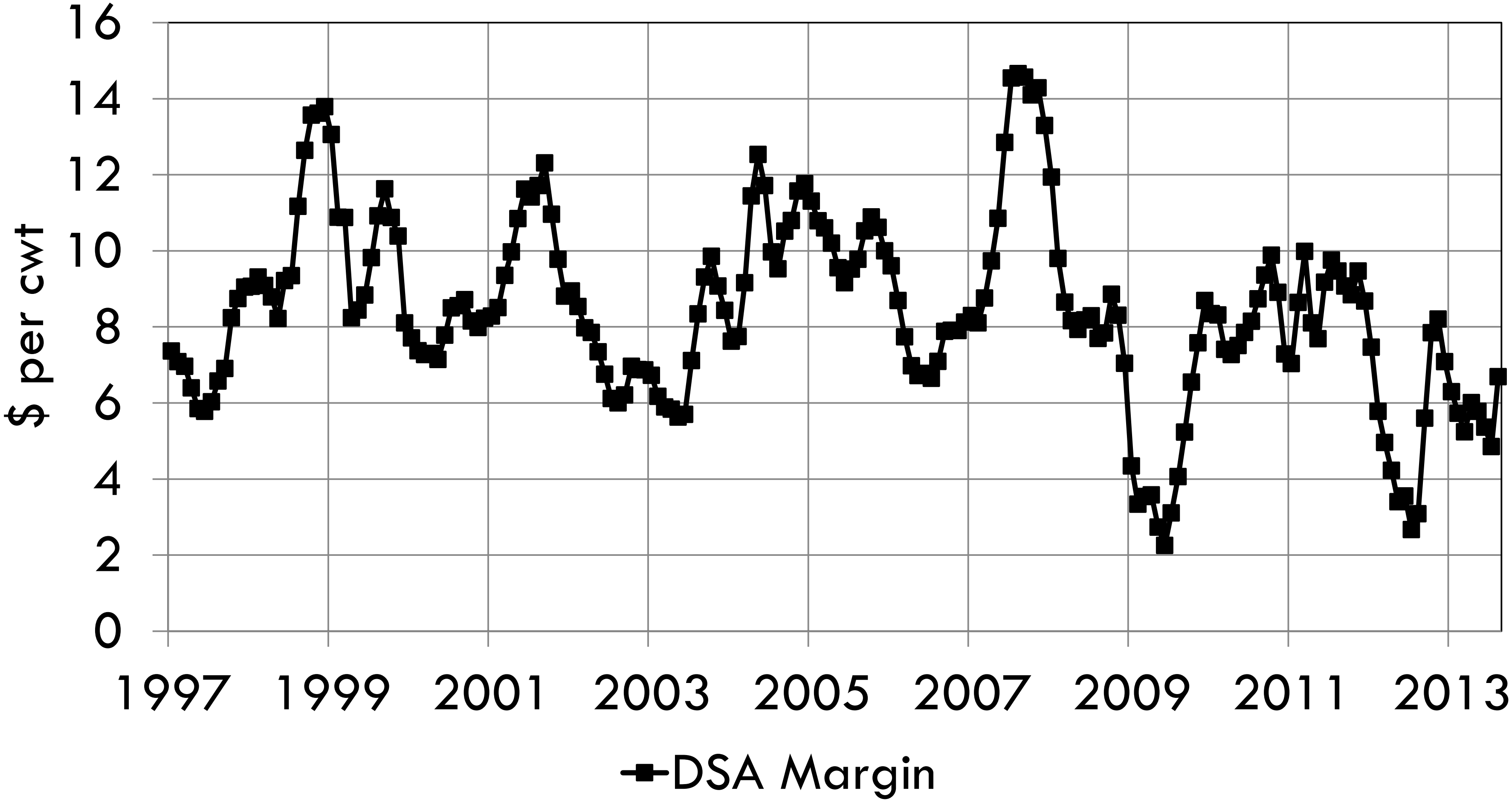
# How Does Your Operation's Margin Compare to the U.S. Margin?



# Senate Dairy Provisions

- Producer participation is voluntary
- Dairy Producer Margin Protection Program (DPMPP)
  - Base Program – 80% historical base, margin < $4 triggers payments
  - Supplemental Program – Producer can buy-up margin coverage, up to $8 coverage, lower premiums for the first 4 million pounds, **supplemental base adjusts**, 25 to 90% annual coverage choice
- Dairy Market Stabilization Program (DMSP)
  - Producer milk marketings capped when margins < $6
  - U.S. to world price triggers kick out the program
- Annual registration fee

# How does the Dairy Market Stabilization Program work?

- $6 for 2 consecutive months
  - Producers paid for 98% of their base milk marketings
  - Maximum reduction is 6% of current milk marketings
- $5 for 2 consecutive months
  - Producers paid for 97% of their base milk marketings
  - Maximum reduction is 7% of current milk marketings
- $4 for 1 month
  - Producers paid for 96% of their base milk marketings
  - Maximum reduction is 8% of current milk marketings

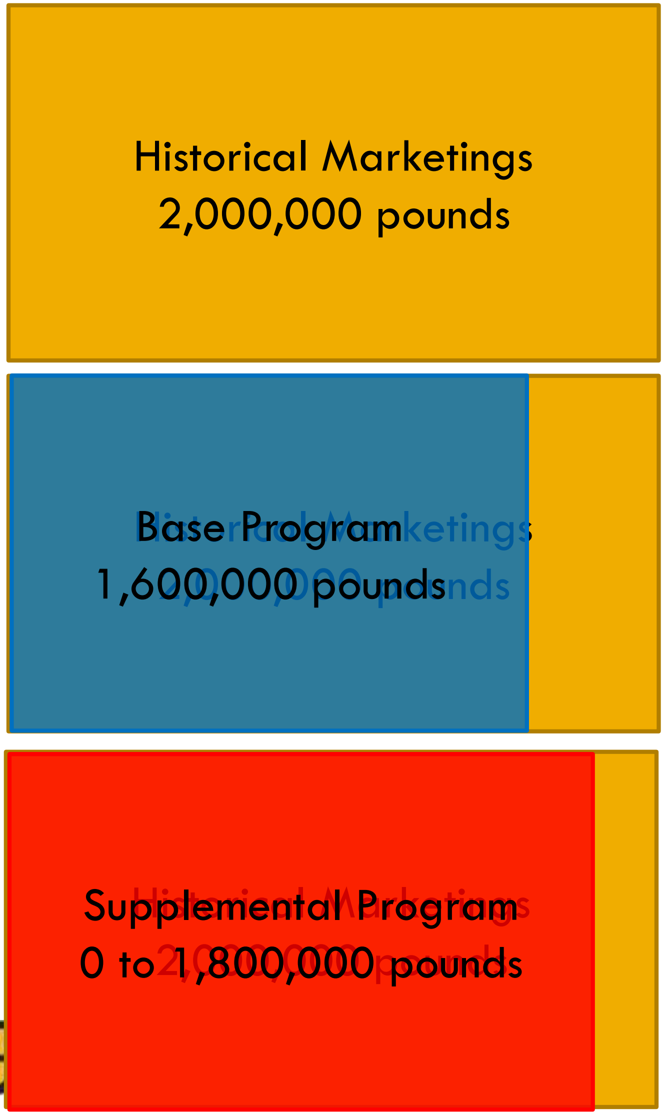
# House Dairy Provisions

- Producer participation is voluntary
- Dairy Producer Margin Protection Program (DPMPP)
  - Producer can buy-up margin coverage, up to $8 coverage, lower premiums for the first 4 million pounds, **base adjusts**, 25 to 80% annual coverage choice

# There Are Different Premiums For Each Coverage Level

| | Senate Bill | | House Bill | |
|---|---|---|---|---|
| Coverage Level | First 4 million lbs | Above 4 million lbs | First 4 million lbs | Above 4 million lbs |
| $4.00 | $0.000 | $0.000 | $0.000 | $0.030 |
| $4.50 | $0.010 | $0.020 | $0.010 | $0.045 |
| $5.00 | $0.020 | $0.040 | $0.020 | $0.066 |
| $5.50 | $0.035 | $0.100 | $0.035 | $0.110 |
| $6.00 | $0.045 | $0.150 | $0.045 | $0.185 |
| $6.50 | $0.090 | $0.290 | $0.090 | $0.290 |
| $7.00 | $0.400 | $0.620 | $0.180 | $0.380 |
| $7.50 | $0.600 | $0.830 | $0.600 | $0.830 |
| $8.00 | $0.950 | $1.060 | $0.950 | $1.060 |
| | | | | |

# Farm Example – Senate Margin Insurance




First decision: Does the producer participate?

If yes, then this farm has two choices regarding supplemental coverage:

1) Level of coverage 0%, 25% to 90%
2) Allow for growth in marketings

# Farm Example – Senate Margin Insurance

Historical Marketings
2,000,000 pounds

Year (N-1) Marketings
3,000,000 pounds

Base Program
1,600,000 pounds

Historical Marketings
2,000,000 pounds

Base Program
1,600,000 pounds

Year (N-1) Marketings
3,000,000 pounds

Supplemental Program
0 to 1,800,000 pounds

Historical Marketings
2,000,000 pounds

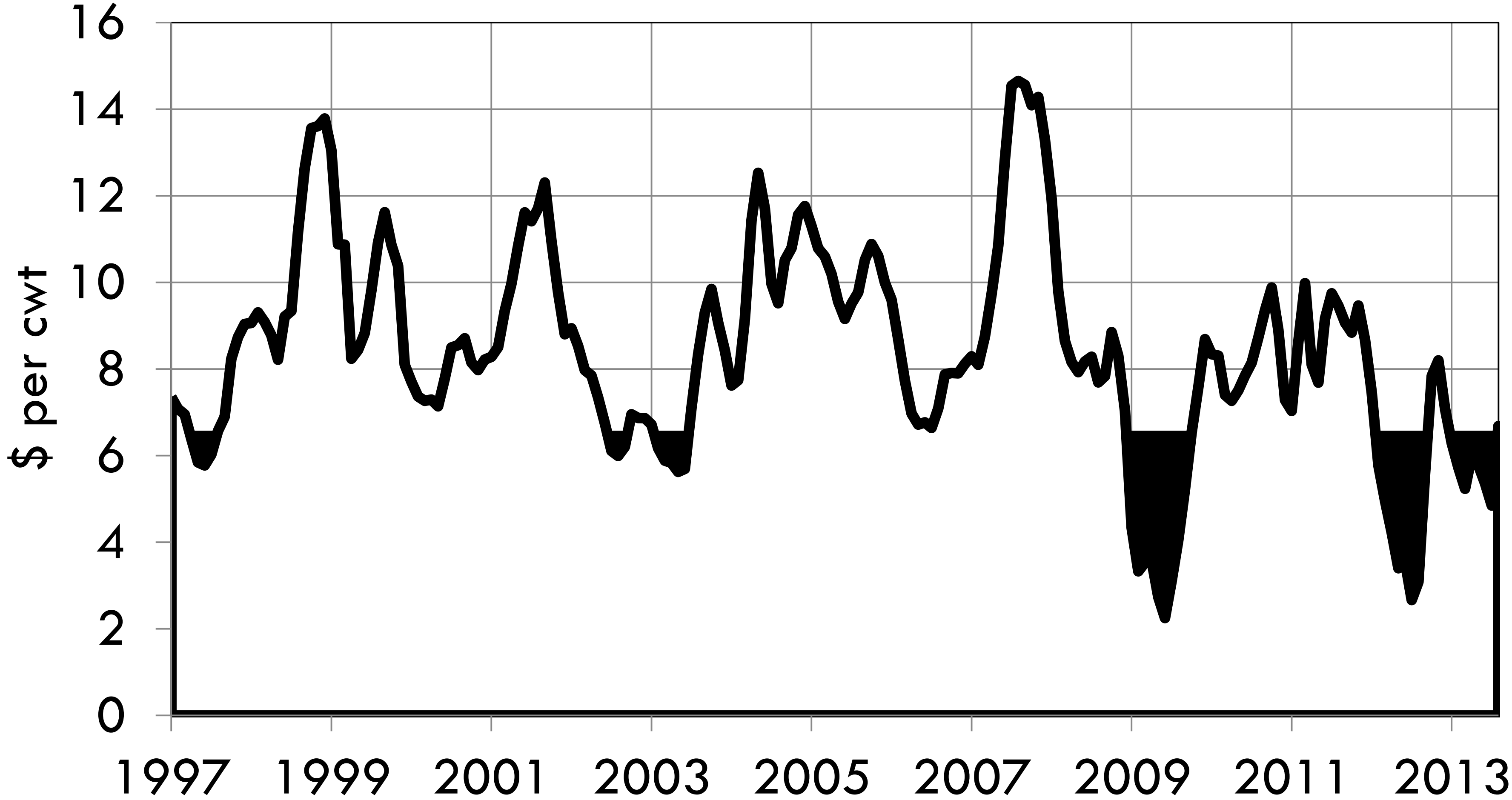
Supplemental Program
0 to 2,700,000 pounds

Year (N-1) Marketings
3,000,000 pounds

# Other Details

- You need to sign up for the life of the farm bill
- You need to pick a coverage level at the beginning of each year
- Remember, you can use other risk management tools with this type of program
  - Futures market
  - Forward contract

# You Could Pick $6.50 Coverage

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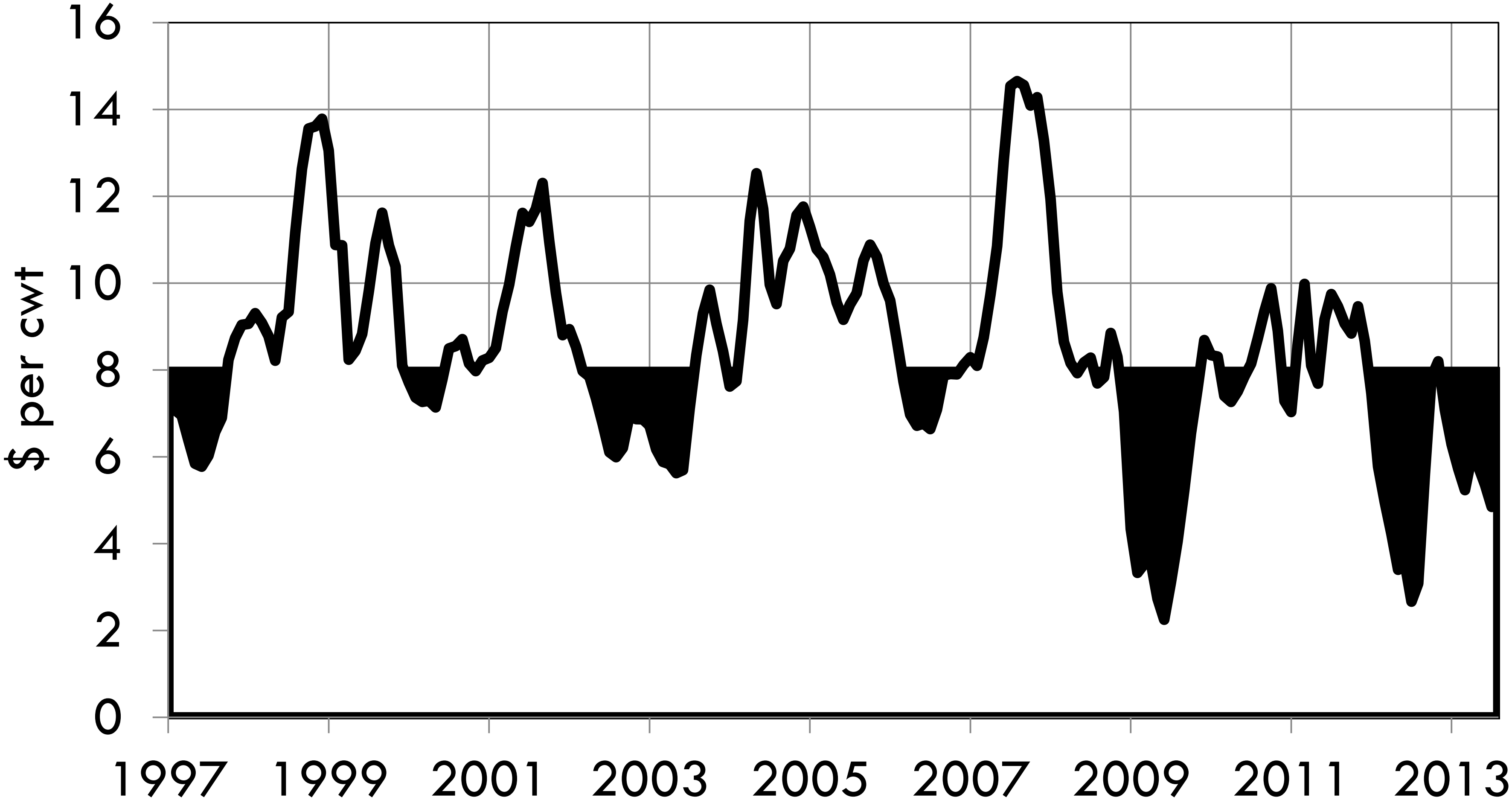
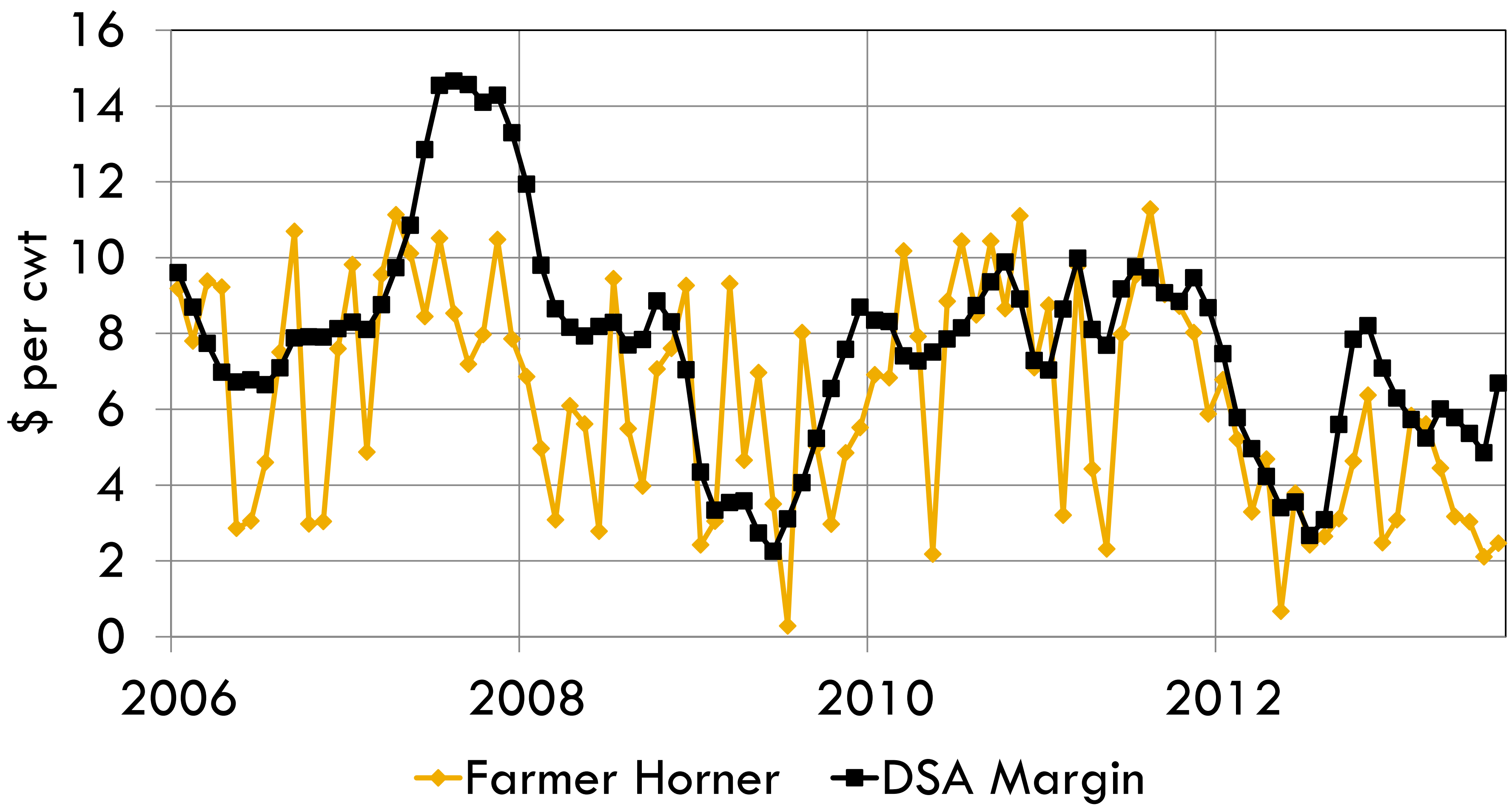
# You Could Pick $8.00 Coverage



# Should This Producer Sign Up? Horner Example

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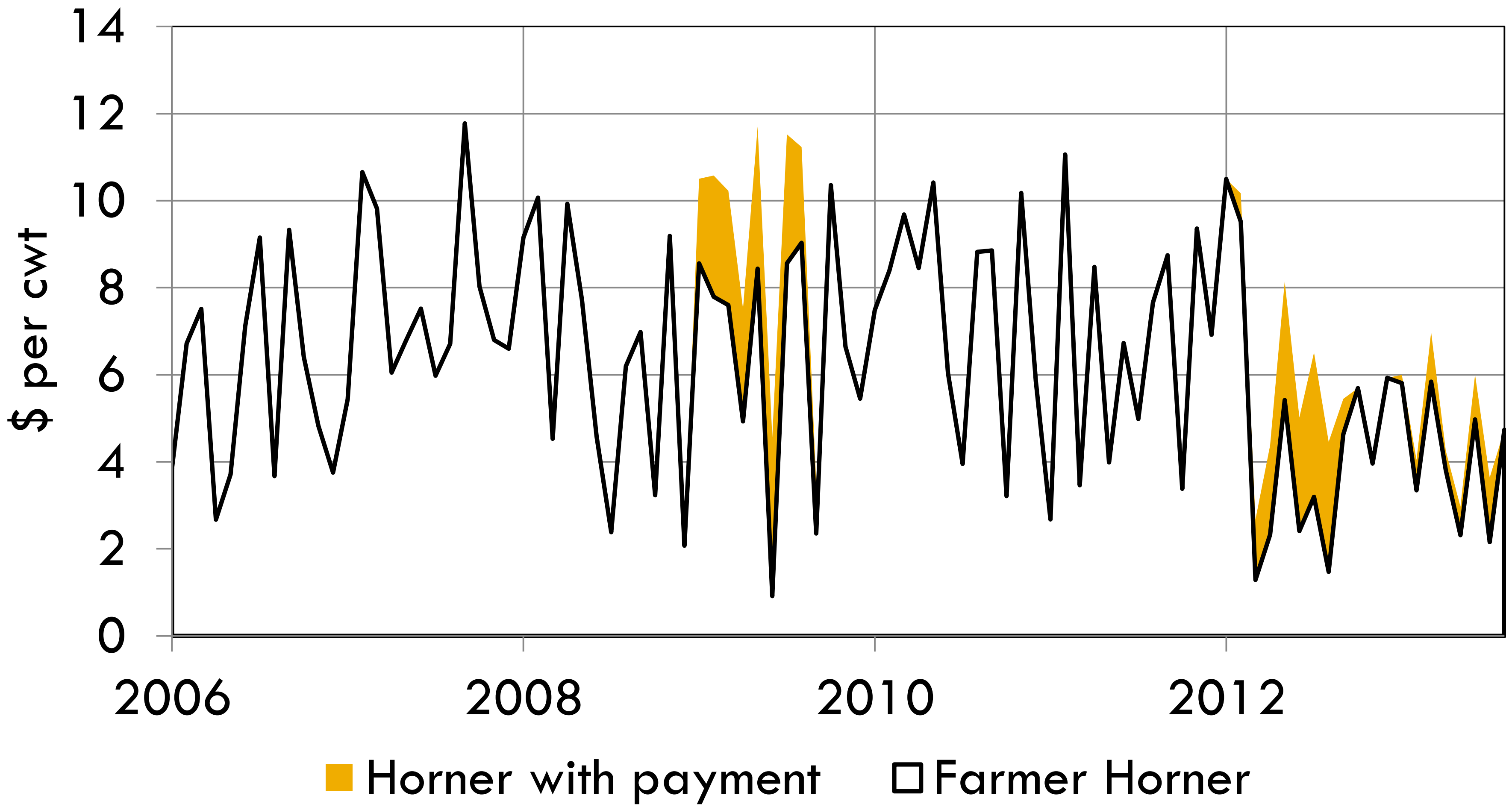

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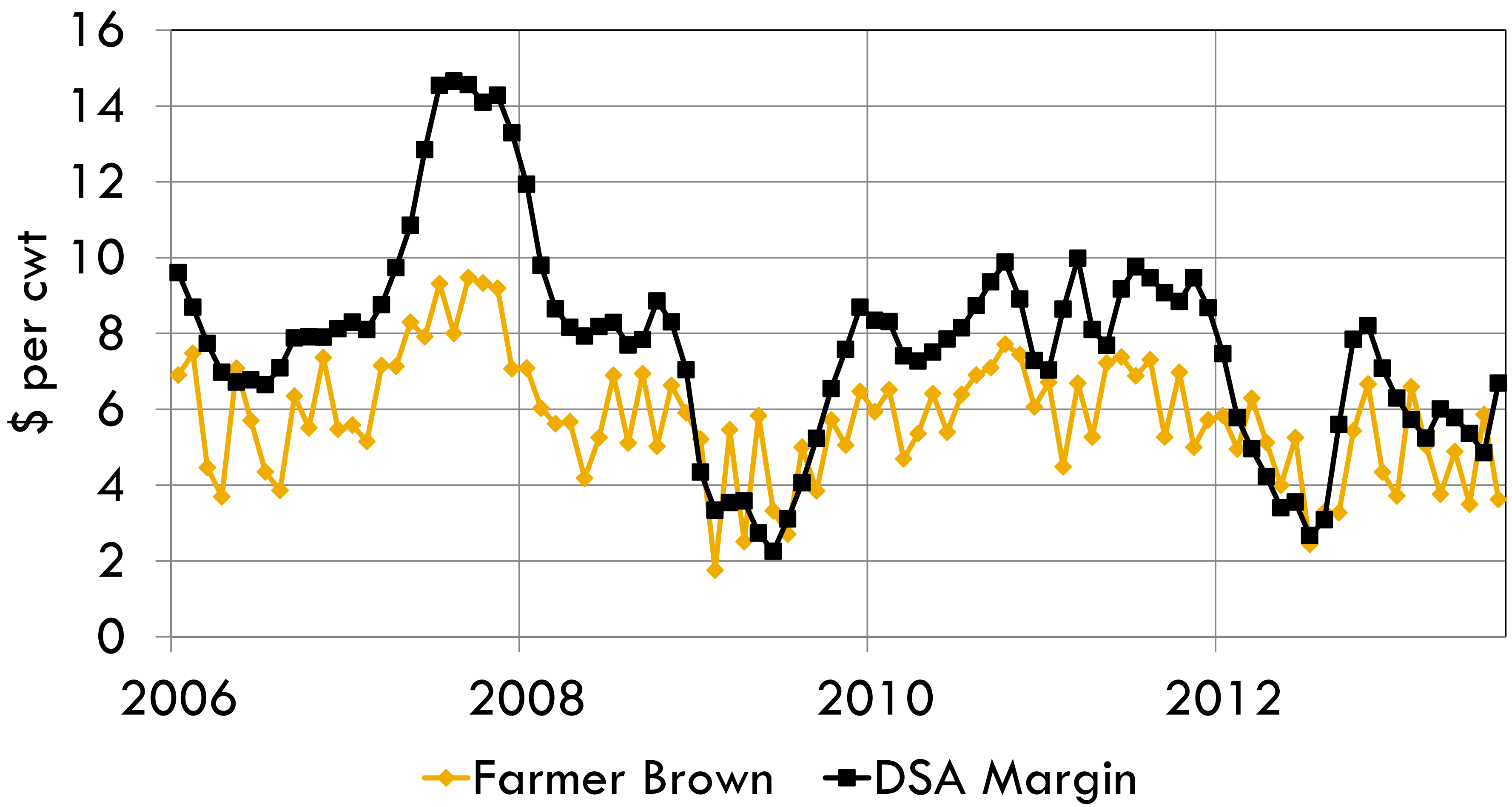


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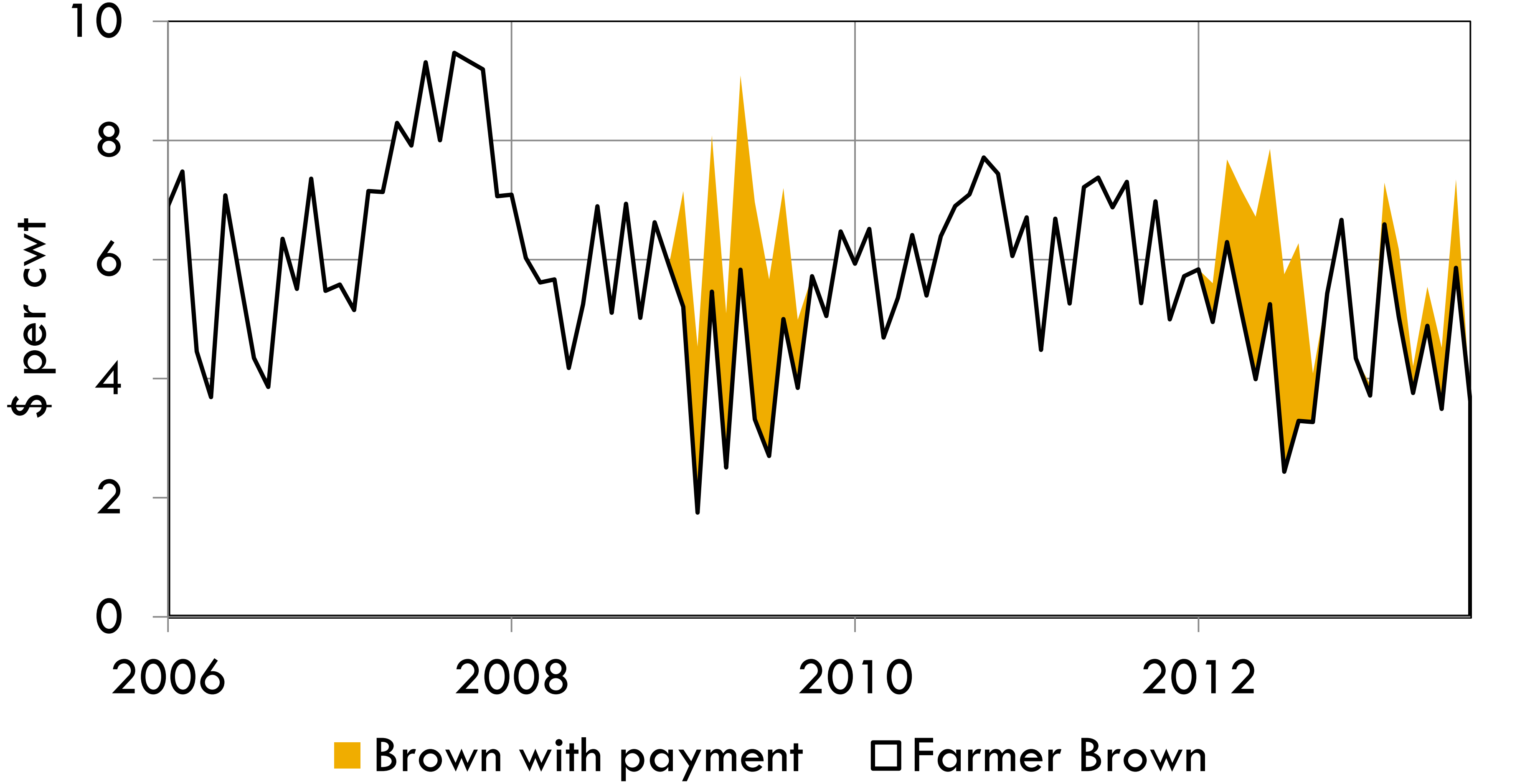


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# You Must Factor In Other Producers' Response

- Senate version
  - If sign up is large, market stabilization could play a big role and could make it more attractive to stay out
  - If sign up is small, market stabilization could play a smaller role making sign up for margin insurance important
- House version
  - If sign up is large then sign up is more important because margin insurance payments prolongs low market prices
  - If sign up is small then opting out carries less risk of long low market outcomes
- Signup for the life of the farm bill

# Summary

- Still early in the process in determining exactly how these programs would be passed and implemented
- USDA would have to issue rules once the farm bill is passed
- Expect calculators from academics to be available for you to help with the choice
- Do not expect the next five years to be like the 2009 to 2013 period