Agricultural ACT of 2014, Fact Sheet

Dairy MPP – Strategies for MY Farm

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Sign-up for the Farm Bill’s new Dairy Margin Payment Protection Program (MPP) runs until November 28, 2014. MPP allows producers to protect the milk price/feed cost margin at a level the producer selects, from $4.00 to $8.00. This fall, dairy producers must decide whether to sign up for the program and at what coverage level.

**SHOULD I SIGN UP?**

The first decision to consider is whether to enroll in MPP or not. If you are currently not using a risk management tool, MPP is a good risk management option. Another benefit: If you sign up for MPP in 2015, your official production history at FSA (what you’re paid on) will be increased by 0.87% (multiply your production history by 1.0087).

**HOW MUCH MILK SHOULD I PROTECT?**

This decision should be answered by answering another question: What is your current risk management strategy and what programs you are using? What percentage of your production is currently protected? Utilize MPP to cover the remaining portion of unprotected production.

**WHAT COVERAGE LEVEL SHOULD I CHOOSE?**

The best way to determine how the program will benefit your operation is to run several scenarios using the national MPP online decision tool available at [www.fsa.usda.gov](http://www.fsa.usda.gov).

The tool is easy to use. Enter your annual production history and it will project the likelihood of receiving a payment based on current futures prices for both milk and feed.

If producers want to simplify the number of scenarios they consider, the University of Minnesota Extension farm bill education team suggests evaluating three options.

The first strategy to consider is to simply enroll at the minimum $4.00/cwt coverage level, often called "catastrophic coverage."

The second option is a risk management strategy. It selects a coverage level that mitigates risk, such as $6.50 coverage. The coverage level is maintained throughout the program.

The third strategy is to select your coverage each year by picking the option that the decision tool predicts will lead to the highest net return.
The MPP decision tool was used to evaluate these strategies using two example farms. One sample farm had 4 million pounds of annual production (4M). The other had 20 million pounds (20M). In both examples, 90 percent of production was covered by MPP.

#1: Only Catastrophic

The first strategy—choosing $4.00 catastrophic coverage every year—resulted in payments only in 2009 and 2012. From 2008 to 2013, both example herds would have averaged a $0.10/cwt/year payment. This strategy does not offer much protection, but the cost is very low with just the $100 per year administration fee.

#2: Risk Management

The second strategy provides strong coverage at a low cost. Premiums jump significantly past the $6.50 coverage level shown in figure 1.

Enrolling at $6.50/cwt every year, payments would have been received in 2009, 2012 and 2013. In 2008, 2010 and 2011 premiums would have been paid without receiving a payment. This resulted in a $0.54/cwt/year average payment for the 4M pound herd and $0.40/cwt/year for the 20M pound herd. Although this strategy doesn’t maximize payments, it does manage risk by covering the income gap in low margin years. This can be seen in figure 2 (provided by the National Milk Producers Federation).

#3: Maximize Predicted Net Return

The third strategy uses the decision tool to select the coverage level each year that predicts the highest net return. The decision tool predicted choosing $4.00 coverage in 2008, and buying $8.00 coverage from 2009 to 2013 for the 4M pound herd. The tool predicted average net returns at $0.62/cwt/year, but actual net returns would have been $0.69/cwt/year. This strategy would have resulted in the highest returns, but does require more analysis of the decision tool projections.

For the 20M pound herd, the tool projected choosing catastrophic coverage in 2008, selecting $8.00 coverage in 2010 and 2011, and selecting $6.50 coverage in 2009, 2012 and 2013. The predicted return from this strategy was $0.25/cwt/year, but the actual return would have been $0.34/cwt/year.

Results for all three strategies are provided in figure 3. The highest return for a 4M pound herd occurs when using the third strategy, selecting the highest predicted payments for each year. For the 20M pound herd, the risk management strategy, $6.50 coverage every year results in the highest net returns.
Regardless of the strategy, it's important to figure out your feed margin, which can be used to calculate your MPP coverage needs. MPP is calculated after feed has been paid, which means that it is protecting what is left to pay non-feed costs. In order to maximize your protection while minimizing your MPP costs, calculate your feed margin to figure out your MPP coverage.

To calculate your feed margin, subtract your feed cost from your milk price. Subtract the national MPP margin from your feed margin to get your adjustment. This is the amount over/under the national margin that is available to pay non-feed costs. Subtract this adjustment from your non-feed costs to arrive at the MPP coverage level needed. Note: this calculation covers 100% of your production. However, MPP covers a max of 90% so you’ll need to divide this by .9 (90%) to calculate the coverage level needed to cover all of your non-feed costs. The values, presented in Table 1, were calculated from FINBIN data.

**Table 1: MPP vs MN Margin.**

<table>
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<th>MILK/CWT</th>
<th>- FEED/CWT</th>
<th>= FEED MARGIN</th>
<th>- MPP MARGIN</th>
<th>= MN ADJ.</th>
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<td>- MN ADJ.</td>
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**FINAL THOUGHTS**

MPP is a risk management tool designed to provide protection for years like 2009. In years with high margins there will not be a payment, but overall MPP provides protection will help dairy farms minimize losses and stay in business.

**Important points to remember:**

- MPP is a yearly decision. Coverage changes can be made each year.
- Know your feed margin
- Know your farm’s financial health and compare your farm to other MN dairies in FINBIN (FINBIN.umn.edu)

**Useful Links**

- MPP Online training is available at [farmbill.umn.edu](http://farmbill.umn.edu)
- UMN Extension Agricultural Business Management: [z.umn.edu/DairyFarmBill](http://z.umn.edu/DairyFarmBill)
- Dairy Markets and Policy: [www.dairymarkets.org](http://www.dairymarkets.org)