

Stabilization would impact farms differently

Simple and fair, or too simple to be fair for your farm?
Run your numbers to determine the impact on your farm.

by John Newton, Cameron Thraen and Marin Bozic

ALBERT Einstein once said "Everything should be as simple as it can be, but not simpler." Deeming MILC as insufficient and Live-stock Gross Margin-Dairy too complicated, dairy producers requested that their leadership come up with new policy instruments that are simple to use and fair in financial impact.

The Senate vision of such a solution is a dairy margin insurance program coupled with a Dairy Market Stabilization Program (DMSP). In our earlier article in the May 25, 2013, issue on page 367, we discussed margin insurance. In this article, we will help you decide if the presence of the stabilization program makes any difference in your participation decision.

The Senate bill's foundation

At a conceptual level, proponents of DMSP argue that stabilization is a very reasonable idea. It starts from a premise that the devastating boom-bust cycle in dairy farm profits can only be broken by gaining temporary control of U.S. milk production during times of low farm returns. Would it not make sense then, stabilization program proponents say, if everyone were incentivized to cut back a little bit so that milk prices can recover faster?

The devil is in the absence of details. What should be of keen interest to dairy farmers trying to decide if they wish to participate in the new safety net program, is a discussion of the adjustment costs they would have when the DMSP is triggered. Once DMSP is triggered, participating farms will have a choice of either (1) cutting back on their milk shipments and thereby avoiding the DMSP revenue penalty, or (2) continuing to ship and

donate the revenue from milk sales over base. In either case, proponents argue, you will be doing your fair share by slowing the growth of milk production in times of low margins or making a financial contribution to stimulate demand for dairy products.

In making your participation decision, you need to carefully consider changes in farm revenue and operating costs from cutting back milk production. On the revenue side of the farm balance sheet, two factors must be considered: milk price and cow productivity.

For milk pricing the key factor to understand is that U.S. federal dairy policy is designed to price fluid milk higher than manufactured products. Consequently, areas with higher fluid milk utilization tend to have higher mailbox prices. For example, over the 2008 to 2012 period, Florida mailbox milk price was \$20.46 while New Mexico mailbox price was only \$15.47.

If you choose to participate, any indemnity check you will get will be based on national average feed costs and the national All-Milk price. But the revenue you will forgo by reducing milk supply is based on your personal mailbox milk price, thus the financial burden of accelerating margin recovery may not be distributed evenly.

In the figure, we mapped the difference between state-level mailbox milk prices and the national All-Milk price. The higher that difference is the higher is the likely change in farm revenue from reduced milk marketings. If your farm is in the Southeast, your adjustment in farm revenue is likely to be much higher than those of a similar farm located in Western states.

What about high-component milk?

Similar arguments can be made for farms that have invested in raising their milk solids level, rather than milk yield per cow. Of the

9.2 million dairy cows in the U.S., an estimated 900,000 are Jerseys. To demonstrate the effect of milk composition on the DMSP adjustment costs, let us compare a high-component herd with 4.8 butterfat and 3.7 protein against a herd with standard component tests of 3.5 butterfat and 3.1 protein.

Between 2008 and 2012 the average milk price for high-component herds was \$4.28 higher than the price received by standard component herds. These prices exclude premiums, authorized deductions, somatic cell count adjustments and the producer price differential. DMSP cutbacks may range from 2 to 8 percent of base milk marketings, and as can be seen in the table, DMSP may trigger greater revenue reductions on milk with higher milk solids.

Input costs may also tweak decisions

In addition to milk price and cow productivity, an additional variable you should take into consideration are changes in your cost of production from drying off or culling the least productive animals or altering the feed ration.

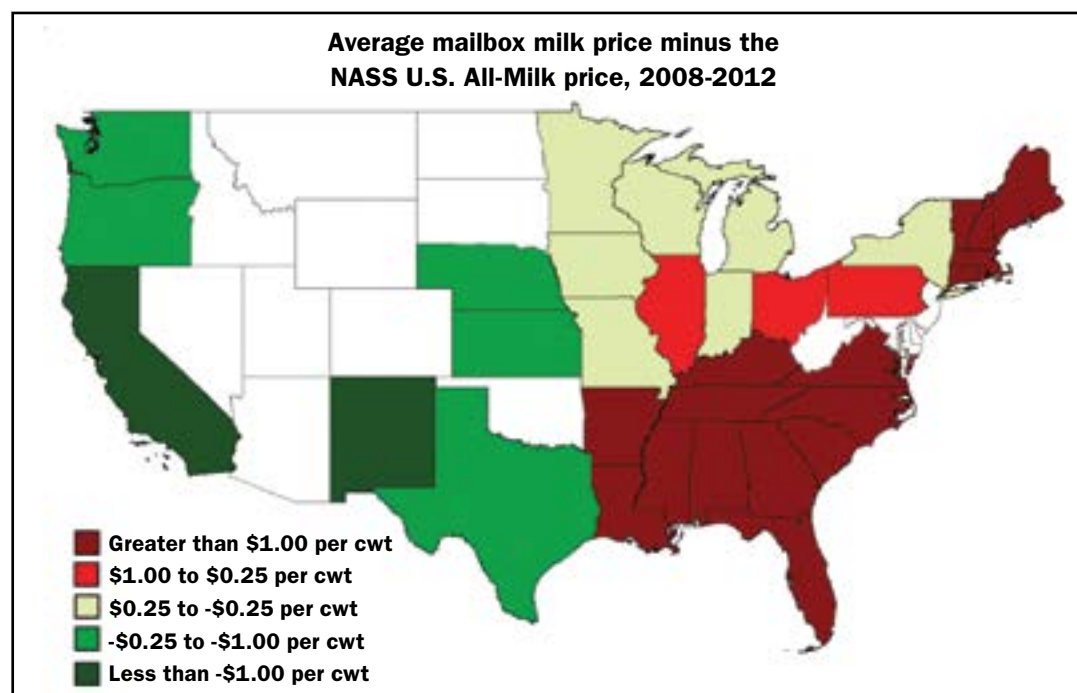
According to USDA data, during 2012, total feed costs represented 56 percent of total milk production costs and ranged from a low of \$10.23 in Idaho to a high of \$18.93 in Maine. Reducing the size of the milking herd may provide the opportunity to achieve costs savings; however, the potential savings are not the same among dairy farmers. Farms with lower costs of production may find it easier to endure the negative margin on milk shipped over base.

Run your own numbers

It is important to recognize that while the new programs may work well for many producers, ultimately you need to compare your own farm's costs and benefits of participation. You must consider a number of parameters in order to determine if margin insurance coupled with market stabilization is the appropriate safety net for your dairy farm operation. Not the least of these decisions is what the DMSP changes in revenue and costs may be for your farm operation. Changes in revenue due to DMSP may be high enough relative to your expected indemnity and projected cost savings to justify opting out of the new dairy policy safety net.

Once the farm bill is passed, with or without market stabilization, our team of researchers from The Ohio State University, University of Illinois, University of Wisconsin, University of Minnesota and Michigan State University will release an interactive online tool that will help you evaluate how the new programs would perform for your particular farm and help you decide what to do. 🐄

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High- and standard-component herd milk prices

	3.5% milk	High component milk
Milk price (\$ per cwt.)		
08-12 avg.	15.80	20.08
DMSP rate (\$/cwt.)¹		
2%	0.32	0.40
3%	0.47	0.60
4%	0.63	0.80
5%	0.79	1.00
6%	0.95	1.20
7%	1.11	1.41
8%	1.26	1.61

¹ Percent of average milk price in \$ per cwt.