MIDWEST DAIRY COALITION

DISCUSSION DRAFT (2-20-14)

Implementation Questions and Recommendations regarding the Dairy Provisions of the 2014 Farm Bill

The 2014 Farm Bill includes a new approach to dairy policy, called the Margin Protection Program, which provides dairy producers with greater options for managing the risk of tight margins (milk price minus feed cost). While producers are given greater choices for risk management, producers must also pay a partially subsidized premium for the coverage. This is a different approach from the Milk Income Loss Contract (MILC) program, which has been the dominant dairy safety net program since 2002, and for which there was no cost to producers. The MILC is scheduled to sunset as the new Margin Protection Program begins.

The Farm Bill lays out many of the parameters of the Margin Protection Program and the related Dairy Product Donation Program, but some of the details must be fleshed as part of a USDA rulemaking process in the coming months. These implementation details, and the related educational activities to inform producers about their options, will be critical to the success of the new programs.

In that context, the Midwest Dairy Coalition is providing the following discussion document regarding some of the implementation questions that must be addressed by the Secretary.

Margin Protection Program (MPP)

Structure of Indemnity Payments

Under the Dairy Security Act (DSA) provisions that were part of the Senate version of the Farm Bill, the Dairy Producer Margin Protection Program was structured to have a "basic" margin protection payment at the $4 margin, with zero premium costs to producers, and a "supplemental" margin protection payment, where producers would pay premium on escalating rates based on the level of margin protection they chose.   This would have involved two calculations in order to determine a producer's indemnity payments.

The final 2014 Farm Bill's Margin Protection Program (MPP) is similar, but is structured in a simpler manner. The MPP stills provide a $4 margin coverage level for participating producers at no premium cost, and higher levels of margin coverage with escalating premium costs, but there is no formal distinction between "basic" and "supplemental" margin protection.

The simplified nature of the final MPP structure invites the question about how the indemnity payments will be structured.   Specifically, it is unclear whether there will be two calculations to determine producer's indemnity or one.   For example, since the $4 margin is free, some producers may wish to sign up at the $4 margin level for 90 percent of their production, and then buy coverage at a higher level (e.g. $7 margin) for a smaller percentage of their production (e.g. 50 percent) because of the premium cost associated with doing so.

The benefit of providing such flexibility is that is gives farmers the ability for greater protection against catastrophic losses, at a lower cost. The downside of this approach is that it adds complexity to the program that might hamper participation.

<u>Will Producers be Permitted to Participate in the Margin Protection Program in Later Years, if they Decline to Sign Up Initially?</u>

It is not clear from the law whether existing dairy producers would be required to sign up for the program during the first year of its offering, or would be allowed to wait a year before signing up.

Undoubtedly, there will be a number of dairy producers who will be uncertain about signing up for the new program, given the fact that it is more complex than the Milk Income Loss Contract (MILC) program, and requires some financial contribution on their part to buy up to higher levels of protection. While there will be a great deal of educational activities by USDA, dairy producer cooperatives and others in the industry to inform producers about the new program, there will likely be some producers who will prefer to wait before signing up, to observe the program's operation for a year before signing up.

The Midwest Dairy Coalition recommends that producers who choose to wait a year before signing up for the MPP should be permitted to do so, as part of the effort to help producers transition smoothly toward a new dairy safety net policy.   On a related matter, while a producer's production history will be based on the highest production from calendar years 2011, 2012, or 2013, the incremental growth permitted in their production history (reflecting the increase in the national average milk production) should be allowed for all participating producers, whether or not they participate in the program for the first year of its operation or sign up later.

The incremental growth permitted in a producer's production history should start from the inception of the program, not the inception of the producer's participation in the program.

<u>How Will the Secretary Balance the Production History Provisions of the MPP with the Provisions Providing Special Considerations for New Dairy Operations, While Still Maintaining the Integrity of the Program?</u>

Producers who sign up for the MPP can only get coverage based on their production history, which is their highest production from calendar years 2011, 2012, or 2013, plus an annual growth allowance equivalent to the national average milk production. While producers are not penalized for any growth in production above their production history, they are not eligible to get any coverage for that growth under the Margin Protection Program.

However, there are provisions that allow for "Election by New Dairy Operations", which sets out the mechanisms for calculating the base history for a new operation, as follows:

- **Election by New Dairy Operations- In the case of a participating dairy operation that has been in operation for less than a year, the participating dairy operation shall elect 1 of the following methods for the Secretary to determine the production history of the participating dairy operation:**

    - **(1) The volume of the actual milk marketings for the months the participating dairy operation has been in operation extrapolated to a yearly amount.**

    - **(2) An estimate of the actual milk marketings of the participating dairy operation based on the herd size of the participating dairy operation relative to the national rolling herd average data published by the Secretary.**

The question this raises is whether a existing producer could get around the limits of the "production history" requirements in order to get coverage for the growth associated with a major expansion of their herd by creating a new herd at another location, and coming in under the "new dairy operation" clause. Similarly, if a farmer decides to move their dairy herd from one state to another and add extra cows at the same time, would they be bound by the production history of the old farm, or would they be able to come in as a new dairy operation?

The Secretary is required to write regulations that would prohibit farmers from "reconstituting" their dairy operation "for the purpose of the dairy producer receiving margin protection payments." See the statutory language below:

- **(a) In General- The Secretary shall promulgate regulations to address administrative and enforcement issues involved in carrying out the margin protection program.**

- **(b) Reconstitution- The Secretary shall promulgate regulations to prohibit a dairy producer from reconstituting a dairy operation for the purpose of the dairy producer receiving margin protection payments.**

- **(c) Administrative Appeals- Using authorities under section 1001(h) of the Food Security Act of 1985 (7 U.S.C. 1308(h)) and subtitle H of the Department of Agriculture Reorganization Act (7 U.S.C. 6991 et seq.), the Secretary shall promulgate regulations to provide for administrative appeals of decisions of the Secretary that are adverse to participants of the margin protection program.**

The Midwest Dairy Coalition recommends that the Secretary write regulations to prohibit farmers from gaming the "new dairy operation" clause of the production history section of the program, without unnecessarily penalizing those producers who genuinely want to move their operations for other reasons?

<u>Definition of Operation</u>

Under the initial implementation process for the MILC program, there was a lot of confusion about how USDA would define "operation" for purposes of MILC payments. For instance, some state FSA offices were allowing multiple payments per operation if there were multiple bulk tanks on the farm, while others were not.

In implementing the MPP, the regulations should specify one common definition of operation nationally, and not allow states FSA offices to enforce different definitions.

Below are the sections of the law that govern the definition of operation, and the related registration process:

SEC. 1401. DEFINITIONS.

- (**5) DAIRY OPERATION-**

    - **(A) IN GENERAL- The term `dairy operation' means, as determined by the Secretary, 1 or more dairy producers that produce and market milk as a single dairy operation in which each dairy producer--**

        - **(i) shares in the risk of producing milk; and**

        - **(ii) makes contributions (including land, labor, management, equipment, or capital) to the dairy operation of the individual or entity, which are at least commensurate with the individual or entity's share of the proceeds of the operation.**

    - **(B) ADDITIONAL OWNERSHIP STRUCTURES- The Secretary shall determine additional ownership structures to be covered by the definition of dairy operation.**

- **1404(b) Registration Process-**

    - **(1) IN GENERAL- The Secretary shall specify the manner and form by which a participating dairy operation may register to participate in the margin protection program.**

    - **(2) TREATMENT OF MULTIPRODUCER DAIRY OPERATIONS- If a participating dairy operation is operated by more than 1 dairy producer, all of the dairy producers of the participating dairy operation shall be treated as a single dairy operation for purposes of participating in the margin protection program.**

    - **(3) TREATMENT OF PRODUCERS WITH MULTIPLE DAIRY OPERATIONS- If a dairy producer operates 2 or more dairy operations, each dairy operation of the producer shall separately register to participate in the margin protection program.**

<u>The Role of Dairy Cooperatives in Facilitating their Members' Participation in the MPP</u>

With regard to the MILC program, many dairy cooperatives helped facilitate their members' participation in that program by providing production records to USDA, if requested to do so by a producer member. This was not a requirement under MILC, nor is it a requirement under the new Margin Protection Program either. The law only requires participating farmers to provide information necessary for the Secretary to establish production history. See statutory language below:

- **(c) Required Information- A participating dairy operation shall provide all information that the Secretary may require in order to establish the production history of the participating dairy operation for purposes of participating in the margin protection program.**

The implementing regulations should permit, but not require, dairy cooperatives to facilitate their members' participation in the MPP if asked to do so by the producer.

Such services could include providing the producer's production data to USDA to help in establishing a producer's production history. In addition, many cooperatives would be willing to deduct premiums from a participating producer's milk check if requested by the producer and USDA to do so, as long as USDA calculates the deduction amount and provides that data to the cooperative. The cooperative should be permitted to facilitate participation in the program, without being legally liable to enforce premium payment.

Methods of Payment for MPP premiums

Section 1407 of the 2014 Farm Bill requires USDA to provide participating farmers with flexibility in methods of paying their annual MPP premiums, while still maintaining "program integrity." The Secretary is also authorized to waive premiums under unusual circumstances, such as "death, retirement, permanent dissolution of a participating dairy operation, or other circumstances as the Secretary considers appropriate to ensure the integrity of the program**."**

See statutory language below on this topic:

- **(d) Time for Payment of Premium- The Secretary shall provide more than 1 method by which a participating dairy operation may pay the premium required under this section in any manner that maximizes participating dairy operation payment flexibility and program integrity.**

- **(e)(2)LEGAL OBLIGATION- A participating dairy operation in the margin protection program for a calendar year shall be legally obligated to pay the applicable premium for that calendar year, except that the Secretary may waive that obligation, under terms and conditions determined by the Secretary, for any participating dairy operation in the case of death, retirement, permanent dissolution of a participating dairy operation, or other circumstances as the Secretary considers appropriate to ensure the integrity of the program.**

The Midwest Dairy Coalition recommends that the $100 annual administrative fee for participating producers be payable at the time of sign up, and at the beginning of each subsequent program year. Methods of premium payments that should be permitted for producers include: 1) a lump-sum payment at the beginning of each program year; 2) quarterly payments; and 3) monthly payments.

DAIRY PRODUCT DONATION PROGRAM (DPDP)

Procedures Should be Established to Ensure that the Donations Made to Food Banks Do Not Cannibalize on Existing Commercial Sales?

To the extent that food banks use existing funds to purchase dairy products as part of their regular food distribution programs, the Midwest Dairy Coalition recommends that the Secretary establish procedures to ensure that the USDA dairy product donations the DPDP do not simply displace those dairy products that the foods banks are already purchasing commercially. Otherwise, if there is no net increase in commercial use of dairy products as a result of the DPDP, it is neither helping to address low operating margins experienced by dairy producers, not is it increasing access to nutritious dairy products for low-income individuals.

One way to enforce this requirement is to require participating food banks to sign an affidavit saying that they have not reduced their purchases of dairy products as a result of the donation.

[These comments and questions are intended to foster early discussion within the dairy industry about important implementation questions for the dairy provisions of the 2014 Farm Bill, given the short timeframes for program implementation. Comments and feedback are welcome, to steveetka@gmail.com.]