

# Economic Analysis of Proposed Dairy Policy Reforms

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UNIVERSITY OF MINNESOTA  
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## Our group...

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- Cameron Thraen
- Mark Stephenson
- Brian Gould
- Chris Wolf
- Marin Bozic

Midwest Program on Dairy Markets and Policy  
2013 Farm Bill Dairy Analysis Group

Goodlatte-Scott vs. the Dairy Security Act:  
Shared Potential, Shared Concerns and Open  
Questions

Briefing Paper Number 13-01

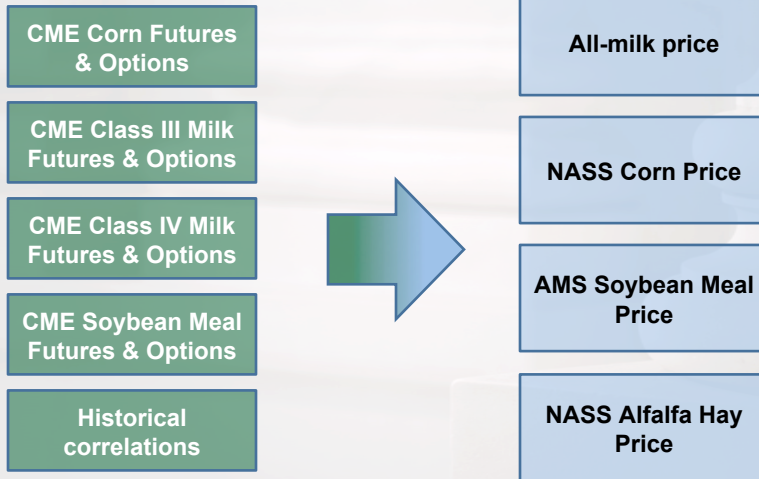
April 15, 2013

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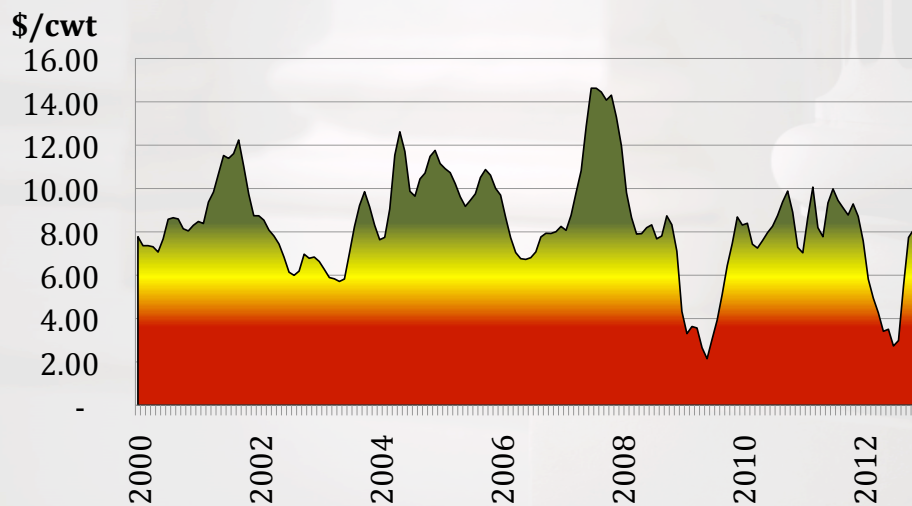
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<http://aede.osu.edu/dairybriefing>

## Estimating expected policy effects using market information



## Is there a case for dairy safety net?



## Dairy Policy Debate

### Agreement:

- Price floors should be abolished.
- Instead of milk price, focus should be on profit margins through catastrophic margin insurance.
- Producers should not be asked to make long-term insurance commitments.

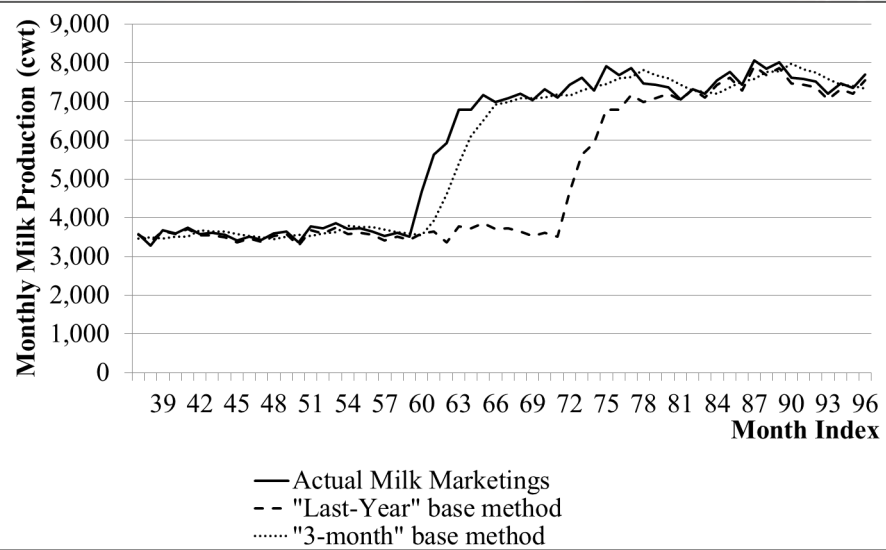
### Disagreement:

- Supply management of some form is an essential policy pillar.

## On Catastrophic Margin Insurance

- *“Both DSA and G-S are very effective in providing catastrophic risk insurance and revenue enhancement for farms with stable and moderately growing milk marketings.” Newton et al (2013)*
- For a producer that insures at \$6.50 coverage level, either dairy proposal would remove about 70% of catastrophic margin shortfall (i.e. margin decline below \$6.50 level).
- Benefits of participating in either program very likely to exceed costs of compliance.

## DMSP: Stabilization base for a growing dairy



## Will DMSP accelerate margin recovery?

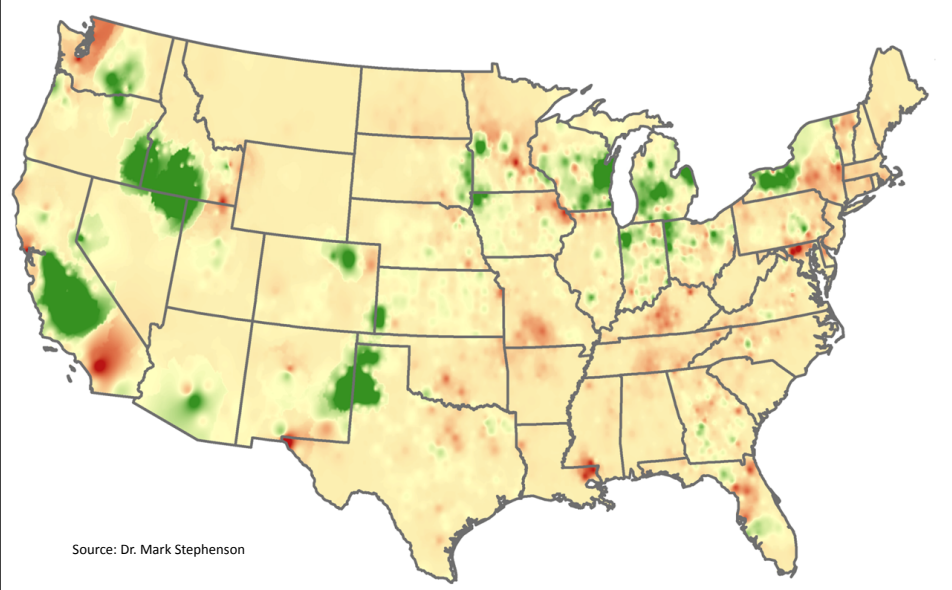
Average Annual Simulated Margin	DSA – if DSMP is Highly Effective	Goodlatte-Scott	How much more likely is scenario under G-S?
Less than \$5.00	1.46%	8.86%	6.1
\$5.00-\$6.00	10.66%	19.96%	1.9
\$6.00-\$7.00	38.88%	29.68%	0.8
\$7.00-\$8.00	30.06%	23.98%	0.8
Over \$8.00	18.94%	17.52%	0.9

Based on margins forecasted with January 15, 2013 data.

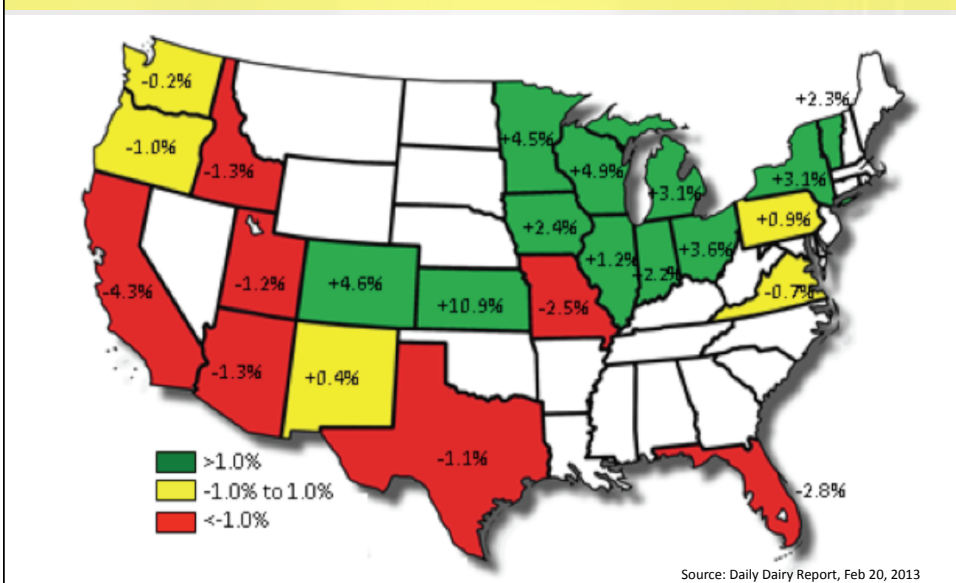
Elasticity of Demand: -0.20

Milk Volume Participation: 75%

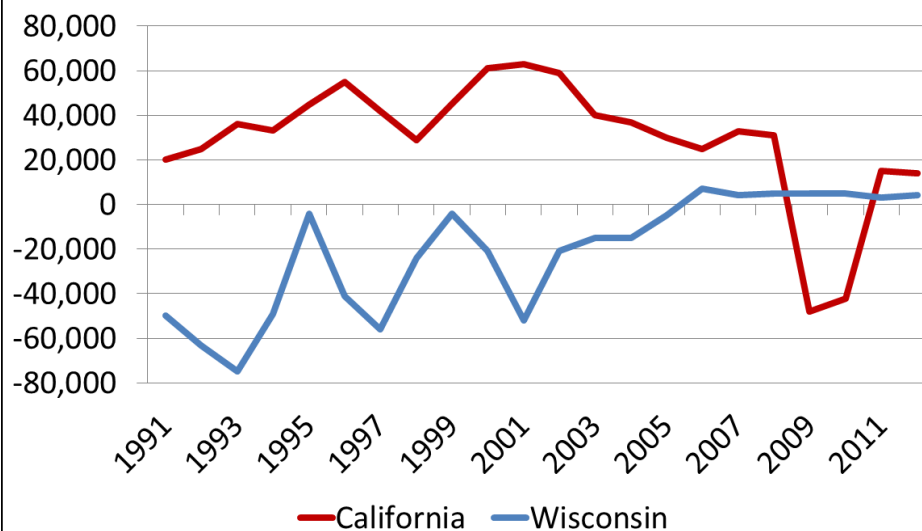
## Change in Milk Production Density 2000-2012



## Jan 2013: Year-on-Year Changes in Milk Production



## Change in Dairy Herd: California vs. Wisconsin



## Can DMSP really be enforced?

**Producer A:** Signs up for the Margin Protection Program/  
Market Stabilization Program

- Gets subsidized IOFC margin insurance
- Gets penalized if his milk marketings exceed stabilization base, when DMSP is in effect

**Producer B:** Does not sign up for the new government dairy safety net programs.

- Must rely on market risk management instruments
- No impediments to milk production

## Cattle Repurchase Agreement (CRA)

- “In case DMSP is triggered, producer B will buy 5% of producer A’s dairy herd.
- Producer A will feed and manage the sold dairy cattle at A’s dairy farm location. Produced milk belongs to producer B and all revenue from milk sales on sold cattle belongs to producer B.
- When DMSP is suspended, producer A has the obligation to buy the cattle back at a price equal to sales price plus “CRA service fee” and less net IOFC income accrued to B during time CRA is in effect.”

## CRA Impacts

- **For producer A:** Milk marketings do not exceed stabilization base. Effectively pays a “service fee” to producer B for transferring ownership of marketed milk for cattle under CRA during the time DMSP is active.
- **For producer B:** Obtains additional revenue for providing a “stabilization base relief valve” service to the producer A who is subject to DMSP.
- **For dairy sector overall:** Milk production is never decreased, DMSP effectiveness is reduced. Instead of an instrument for balancing the milk market, DMSP becomes a tool for transferring income from participating to non-participating producers.

## Supplemental Margin Protection – Premiums for Production over 4 million lbs

Coverage Level	Senate 2013	House 2013	Dairy Freedom Act
\$4.00	\$0.00	\$0.00	\$0.03
\$4.50	\$0.02	\$0.02	\$0.05
\$5.00	\$0.04	\$0.04	\$0.07
\$5.50	\$0.10	\$0.08	\$0.11
\$6.00	\$0.15	\$0.16	\$0.19
\$6.50	\$0.29	\$0.23	\$0.29
\$7.00	\$0.62	\$0.43	\$0.38
\$7.50	\$0.83	\$0.59	\$0.83
\$8.00	\$1.06	\$0.92	\$1.06

Déjà vu  
all over again?



- 1970-1980s: Support prices at 80-85% of parity.
- 2013: “Sweet spot” at \$7.00/cwt?  
That is 84% of the average IOFC over 2000-2012 period.
- 2018: Liquidity of dairy futures markets?  
Milk oversupply?



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