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Policy Watch: The Dairy Security Act of 2011

Dairy Margin Protection Program: A bias against small scale dairy operations?

The Issue

In a review of the Dairy Producer Margin Protection Program (DPMPP) introduced as Title 1:A of The Dairy Security Act of 2011 by House Agriculture Committee Ranking Member Collin C. Peterson, D-Minn., and Rep. Mike Simpson, R-Idaho, the charge is made that the DPMPP is biased against the smaller scale dairy producer and favors the larger scale producer, where scale is measured by herd size (Zulauf). The basis for this conclusion is that the share of non-feed cost relative to total cost of production on a hundredweight basis on small dairy farms is much larger than that of larger scale operations. As the basic margin plus supplemental coverage is designed to make up deficiencies in the non-feed margin, the argument put forth by Zulauf is that the total dollar maximum, including both basic and supplemental coverage, will cover only a small share of the non-feed margin on small dairies, e.g., those with less than 99 head, and will cover a much larger share of the non-feed margin on larger dairy operations, those with more than 500 head. Zulauf reports that the share of non-feed cost covered by the margin protection program is 26% for small scale operations and increases to 81% for large scale operations. (Adjusting for changes in the language of the actual bill, introduced on September 22, 2011, which increased the coverage from 75% to 80% of the producers base production, increasing coverage from \$6.60 to \$6.80 per hundredweight, these percentages are 28% and 94% respectively).

An Assessment

While Zulauf raises an important question as to the potential benefit distribution of the DPMPP, unfortunately his conclusion and policy prescription is incorrect. The Zulauf claim of large scale bias is incorrect for a number of reasons, the most important being that it is based on dubious total cost of production data from the USDA/ERS database for total cost of production by herd size. An examination of the USDA/ERS data shows that while total operating cost, feed and non-feed operating cost, is very similar by herd size, the allocated cost category which includes charges for (i) hired labor, (ii) opportunity cost of unpaid labor, (iii) capital recovery of machinery and equipment, (iv) opportunity cost of land, (v) taxes and insurance, and (vi) general farm overhead, is much greater for the smallest herd size operations. A careful review of the data shows that this much higher allocated cost on the smallest scale operations is primarily determined by a high imputed charge for the opportunity cost of unpaid labor and capital recovery cost. These two items are 117% of total operating cost for the smallest herd category and only 17% for the largest herd size category. In the USDA/ERS data, the charge for opportunity cost of unpaid labor for farms with less than 50 cows was \$11.67 per hundredweight in 2010, the last year for reported data. Using the two smallest herd size categories, less than

100 cows, and the assumed average production per cow of 16,031 pounds, this implies an imputed charge to unpaid labor of \$70,188 per year. This high value for unpaid labor significantly inflates the total cost and the non-feed cost for these small scale operations and is not present in the larger scale operations. Using the USDA / ERS cost data to calculate the ratio of non-feed cost on the smallest herd sizes, less than 100 cows, to the non-feed cost on the largest herd sizes, greater than 500 cows, shows this ratio to be 162% in 2010.

A review of the financial data from highly regarded farm record management programs, such as the FinBin system at the Center for Farm Financial Management, University of Minnesota, or the Dairy Farm Business Summary and Analysis (DFBS) at Cornell University shows that, while the total cost of producing milk on small scale dairy farms is higher than that of larger scale operations, this cost difference is not of the order of magnitude as suggested by the USDA / ERS data. Using the Cornell DFBS published data for 2005 to 2010, the ratio of non-feed cost for small scale dairies, those with less than 110 cows, to the intermediate size dairies, those with 110-499 cows, and the largest scale dairies, those with 500 or more cows, averages only 21 percent and 27 percent higher, respectively.

Using the same margin coverage ratios as presented by Zulauf, calculated from the DFBS dataset, the DPMPP average coverage ratio over the period 2005 to 2010 is 51% for the smallest operations and 64% for the largest. These margin coverage ratios by herd size and year are shown in the following chart.

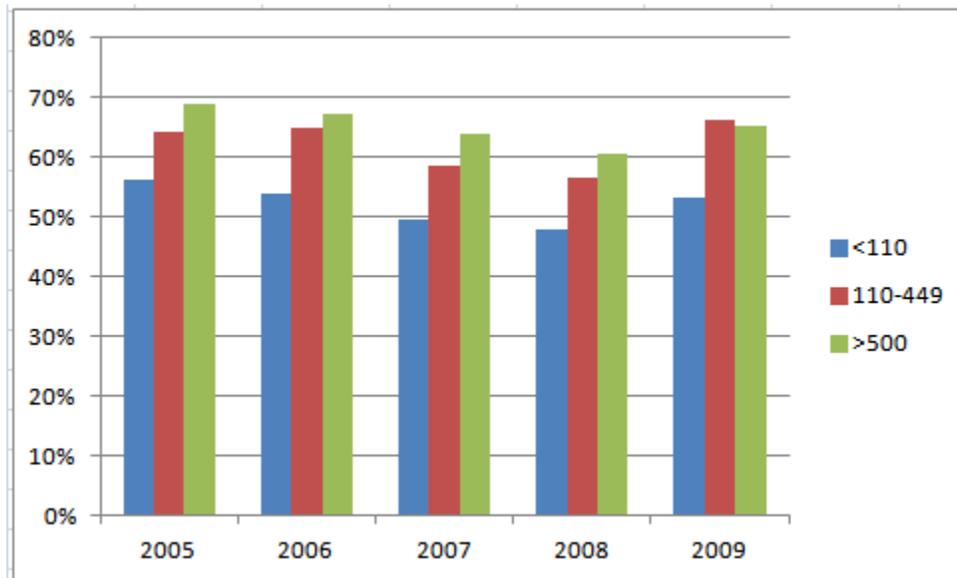


Chart 1. Margin coverage ratio by herd size and year.

Larger scale dairy operations would receive a bit more coverage as they are more efficient on average in putting resources to use in producing milk and do exhibit lower total cost of

production. However this cost advantage is not sufficient to support the claim of scale bias in DPMPP.

Summary

If there is a bias inherent in the programs set forth in Title 1, A and B of the proposed Dairy Security Act of 2011 it is not in the direction identified by Zulauf. It will most certainly be against the larger, more efficient dairy operations, which are likely to choose to not participate given the highly skewed administrative fee structure, the very minimal protection afforded by this program, the rigidity and cost in specifying supplemental margin coverage, and the mandated participation in the Dairy Market Stabilization Program if one chooses to participate in the Dairy Producer Margin Protection Program. The last item, the mandated DMSP participation for the duration of the DSA-2011, is very likely to be perceived as a significant negative to the entire proposed program. For a more complete review of the Dairy Margin Protection Program and the Dairy Market Stabilization Program, Titles I and II of the proposed Dairy Security Act of 2011 go to the Ohio Dairy Web website and link to: *Policy Watch: The Dairy Security Act of 2011*.

References:

Dairy Farm Business Summary and Analysis, State Summaries, 2005 – 2011,
<http://dfbs.dyson.cornell.edu/>

FinBin, The Center for Financial Management, The University of Minnesota,
<http://www.finbin.umn.edu/LivestockEnterpriseAnalysis/Default.aspx>

USDA / ERS <http://www.ers.usda.gov/Data/CostsAndReturns/TestPick.htm>

Zulauf, Carl., “Lower Costs for Larger Dairy Herds Pose Potential Issue with a Dairy Margin Program.”, Department of Agricultural, Environmental and Development Economics, September 2011.

