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Alternative First Year Payment Scenarios Under the New MILC Program

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The US Department of Agriculture has issued rules for producer payments under the new Milk Income Loss Contract (MILC) program. At the time of writing these rules have not been published in the Federal Register and, therefore, are not "final." The following analysis is based on Notice LD-524 and Form CCC-580 issued by the Farm Service Agency.

The prevailing interpretation of the MILC rules is that a producer has two choices for the current 10-month period of December 1, 2001 through September 30, 2002. These are to 1. Start payments with milk shipped on December 1, 2001 and collect payments until either the 2.4 million pound limitation on eligible milk or the end of the fiscal year is reached. 2. Select the month of September only and collect the $1.45 per cwt. payment on that September, 2002 milk. To take option 2, a producer must make the election before the end of August because the rules say producers must sign up in advance unless they take the December 1, 2001 start date. This is only an issue for this first, abbreviated fiscal year and it occurs because the Farm Bill was enacted with retroactive payments. For the remaining three years, a producer can choose the month (in advance) when payments will start. Once the start month is selected, the payments keep coming until the limit is reached on eligible milk. Months with no payments do not count towards this volume limit on milk sales.

There are a number of concerns about this interpretation of the rules and some producer groups are making efforts to change these. Part of the reason for concern is the belief that medium sized farms are placed at a disadvantage because of the pattern of payments rates that has occurred. The payment rate per 100 lb. is $0.77 for milk shipped in December, 2001 and it has steadily increased to a rate of $1.45 per 100 lb. for milk to be shipped in September, 2002. Alternative payment proposals include a level payment plan using the average of the payment rates over the 10-month period, which amounts to $1.08 per 100 lb. A second alternative is to allow producers to select August and September, 2002 as payment months, instead of September alone.

I have made some calculations on alternative MILC program payments for the current period Dec 1, 2001 through September 30, 2002. Table 1 shows the estimated payments and Figure 1 shows these in graph form. I evaluated four scenarios, based on current rules and alternatives proposed by interested groups. These are:

1. Starting payments effective December 1, 2001,

2. Taking payments in September, 2002 only,
3. Starting payments in August, 2002 for milk shipped in August and September, and
4. Payments calculated at the average rate for the entire period, i.e., $1.08 per 100 lb.

I assessed the financial impacts over a range of sizes of milk shipments and used a constant amount of milk shipped per month, for simplicity and ease of calculation, Table 1. The low end of the size range is 240,000 pounds per month, the level at which a producer would reach the production limit on the amount of milk eligible for payment over the 10-month period. At a maximum, I assumed milk sales of the amount of this cap in a single month, i.e., 2,400,000 lb. This would achieve the maximum possible payment under the September option. Note that 2.4 million pounds shipped over the initial 10-month period is equivalent to 2.88 million pounds on an annual basis. At the national average of approximately 18,000 pounds of milk sold per cow, this represents a herd of 160 cows. A shipment of 2.4 million pounds of milk in one month is equivalent to a herd of 1600 cows.

From the graph, it can be seen that, as milk sales increase from 240,000 lb./month to 750,000 lb. per month the total payments per operation decline and then bottom out over the remaining size groups. This supports the contention that the herds in the middle of the range are placed at a disadvantage relative to smaller herds.

The September, 2002 option generates a much larger payment for the largest producers relative to the payments to the other size groups. The breakeven sales volume between the current options of starting the payments in December and selecting the month of September only is approximately 1,275,000 lb./month assuming constant sales volumes in all months.

The August and September payment option also creates larger payments benefits for the larger herd sizes and impacts a larger range of herd sizes. The payments under this option match the payments under the September only option for the largest size group but a wider range of herd sizes would receive these payments. In these calculations, herds above 900,000 lb./month have an advantage relative to the smaller size groups.

The $1.08 average payment generates uniform payments to all the groups evaluated, of course, and removes the observed disadvantage to the herds in the middle of the size range.

These calculations show that alternative payment rules have a markedly different financial impact on herds of different sizes

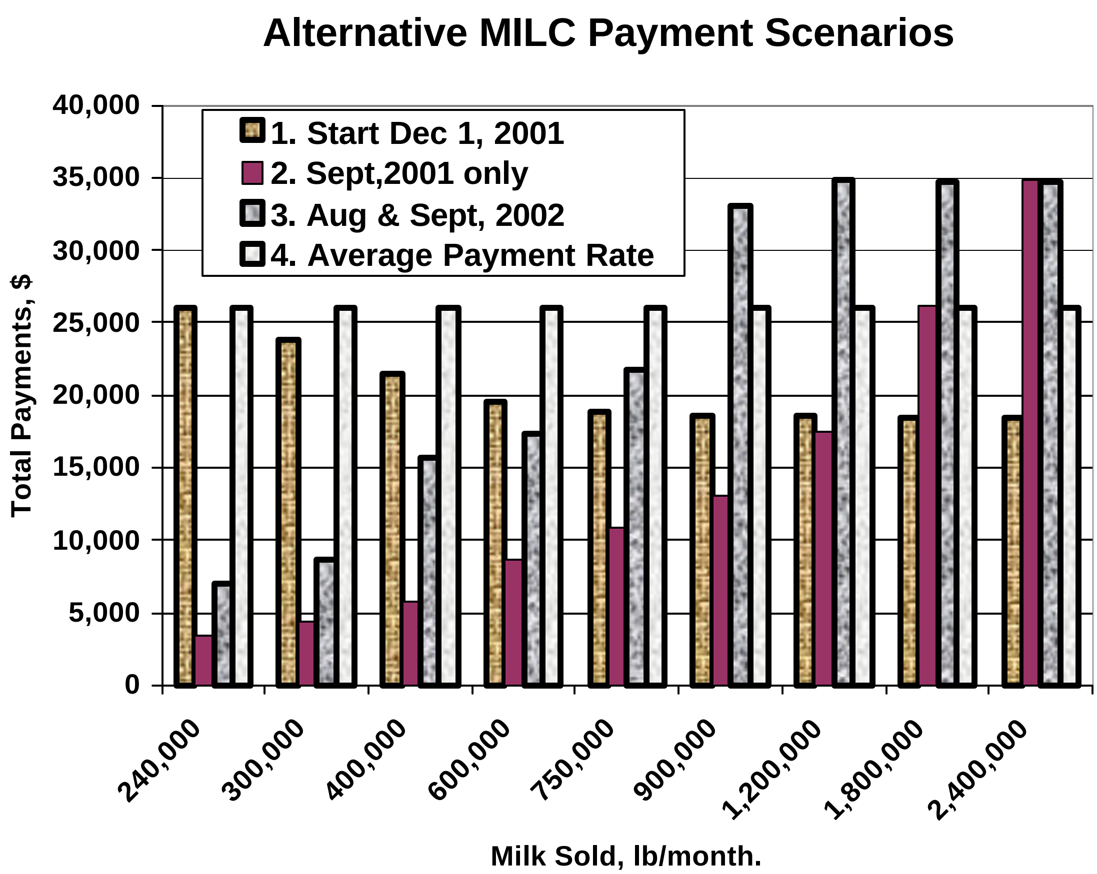

Table 1. MILC Payments under four different scenarios

Milk Sales lb./month	Option 1 Payment	Option 2 Payment	Option 3 Payment	Option 4 Payment
	$	$	$	$
240,000	25,996	3,488	6,955	25,996
300,000	23,801	4,361	8,694	25,996
400,000	21,420	5,814	15,649	25,996
600,000	19,575	8,721	17,388	25,996
750,000	18,880	10,901	21,735	25,996
900,000	18,630	13,082	33,037	25,996
1,200,000	18,576	17,442	34,776	25,996
1,800,000	18,522	26,163	34,722	25,996
2,400,000	18,468	34,884	34,668	25,996