Order Code IB97011

CRS Issue Brief for Congress

Received through the CRS Web

Dairy Policy Issues

Updated January 10, 2006

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Dairy Policy Issues

SUMMARY

Several dairy issues are being considered by Congress, some of which affect the three major federal dairy policy tools — the Milk Income Loss Contract (MILC) program, federal milk marketing orders, and the dairy price support program.

Under the MILC program, which expired on September 30, 2005, eligible dairy farmers received a government payment when the farm price of milk used for fluid consumption fell below an established target price. Since the inception of the program, its cumulative cost was nearly $2 billion. However, FY2005 outlays were negligible since farm milk prices were relatively strong. Extension of the MILC program is supported by small to moderate-sized dairy farmers. Large dairy farmers generally oppose program extension in its authorized form, because of its payment limitations.

The conference agreement on the FY2006 omnibus budget reconciliation bill (H.Rept. 109-362, S. 1932) would extend the MILC program until September 2007 at a somewhat lower level of support than the expired program. The issue has been controversial, since the two-year estimated cost of nearly $1 billion for program extension had to be at least partially offset by reductions in other mandatory USDA programs. Final action is expected shortly after the 109th Congress returns for its second session.

Federal milk marketing orders regulate the farm price of milk for roughly two-thirds of U.S. milk production by requiring processors to pay minimum prices for farm milk depending in its end use. S. 2120, as passed by the Senate in December 2005 addresses marketing order issues relevant to the western United States. An identical bill (H.R. 4015) is pending in the House. Under current regulations, producer-handlers (i.e. fluid milk handlers who produce and process their own milk) are exempt from federal order price regulation. H.R. 4015/S. 2120 would require a large producer-handler in Arizona to become regulated. The provision is supported by other milk producer and processor groups who contend that unregulated processors undercut the competition. The producer-handler argues that the provision is a tax being placed on its operations that would adversely affect its business, and ultimately result in higher prices to consumers.

Another federal dairy policy tool, the dairy price support program (DPSP), indirectly supports the farm price of milk through government purchases of surplus dairy products when market prices are low. Earlier this year, the Administration proposed that USDA be given enhanced authority to adjust the government purchase prices of surplus butter and nonfat dry milk. According to the Administration, this would save an estimated $600 million over 10 years. Neither the House or Senate version of the FY2006 budget reconciliation bill adopted this provision, or any other provision that would directly affect dairy price support program spending.

Separately, dairy farmer groups are concerned that imports of milk protein concentrates (MPCs) are displacing domestic dairy ingredients and thus depressing farm milk prices. Bills have been introduced (H.R. 521 and S. 1417) to impose tariff rate quotas on certain MPCs. Dairy processor groups are opposed to this bill.

MOST RECENT DEVELOPMENTS

The conference agreement on the FY2006 omnibus budget reconciliation bill (H.Rept. 109-362, S. 1932) contains a two-year extension of the Milk Income Loss Contract (MILC), which expired on September 30, 2005. The MILC program provides direct payments to participating dairy farmers when the market price of farm milk falls below a legislatively determined target price. The conference agreement would reduce the payment rate to 34% of the difference between the target price and the lower market price, instead of 45% as provided in the original authorizing statute. The agreement reduces the payment rate to 0% in September 2007, effectively ending the program on August 31, 2007, so that the program will have no budget baseline when the next farm bill is formulated in 2007.

Separately, the Senate passed by unanimous consent on December 16, 2005, a bill (S. 2120) that addresses several federal milk marketing order issues that affect Western states. A similar House bill (H.R. 4015) is pending.

BACKGROUND AND ANALYSIS

Milk Income Loss Contract (MILC) Payments

Background

In FY1999-FY2001, Congress provided just over $32.5 billion in emergency spending for USDA programs, primarily to help farmers recover from low farm commodity prices and natural disasters. The majority of these funds were for supplemental direct farm payments made to producers of certain commodities, primarily grains and cotton, but also including soybeans, peanuts, tobacco and milk. Of this amount, dairy farmers received supplemental "market loss" payments of $200 million in FY1999 under the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (P.L. 105-277), $125 million under the FY2000 agriculture appropriations act (P.L. 106-78), and $675 million under the emergency provisions in the FY2001 agriculture appropriations act (P.L. 106-387).

Some dairy farmer groups sought a permanent direct payment program for dairy farmers to be included in the 2002 farm bill as a means of supplementing dairy farm income when farm milk prices are low. Prior to the emergency payments made each year on an ad-hoc basis in FY1999 through FY2001, dairy farmers generally were not recipients of direct government payments. However, some groups contended that farm milk prices had been volatile in recent years and that dairy farmers needed more income stability.

Separately, the Northeast Dairy Compact, which provided price premiums to New England dairy farmers when market prices fell below a certain level, expired on September 30, 2001. These premiums were funded by assessments on fluid milk processors, whenever fluid farm milk prices in the region fell below $16.94 per hundredweight (cwt.). Supporters of the Northeast Compact had sought for an extension of the compact; the southeastern states were seeking new authority to create a separate compact. However, dairy processors and Upper Midwest producers are strongly opposed to regional compacts.

MILC Program Mechanics

Section 1502 of the Farm Security and Rural Investment Act of 2002 (P.L. 107-171, the 2002 farm bill) authorized a new counter-cyclical national dairy market loss payment program. (Upon implementation, USDA dubbed the program the Milk Income Loss Contract (MILC) program.) This program did not replace the dairy price support program or federal milk marketing orders, other current federal milk pricing policy tools. Instead, it serves as an alternative to regional dairy compacts and ad-hoc emergency payments to farmers, by authorizing additional federal payments when farm milk prices fall below an established target price. (The MILC program expired on September 30, 2005, as required by the 2002 farm bill. The pending conference agreement on the FY2006 omnibus reconciliation bill (H.Rept. 109-362, S. 1932) contains a two-year extension of the program. See "MILC Program Reauthorization" below for details.)

Under the MILC program, dairy farmers nationwide are eligible for a federal payment whenever the minimum monthly market price for farm milk used for fluid consumption in Boston falls below \$16.94 per hundredweight (cwt.). In order to receive a payment, a dairy farmer must enter into a contract with the Secretary of Agriculture. While under contract, a producer potentially can receive a payment equal to 45% of the difference between the \$16.94 per cwt. target price and the market price, in any month that the Boston market price falls below \$16.94. A producer could receive a payment on all milk production during that month, but no payments are made on any annual production in excess of 2.4 million pounds per dairy operation. Under current law, all contracts expired on September 30, 2005, and payments were made retroactively to December 1, 2001.

The MILC program is akin to the Northeast Dairy Compact, which was in effect in the six New England states from 1997 until its expiration on September 30, 2001. However, under the expired dairy compact, dairy processors were required to pay the full difference between the \$16.94 per cwt. fluid milk target price and any market price shortfall for fluid use milk in the compact region. The MILC program shifted the responsibility of the payment from the processor (and ultimately the consumer) to the federal government.

During the 2002 farm bill debate, the dairy payment program was generally supported by milk producer groups in the Northeast and the Upper Midwest. Producer groups in the Northeast region viewed it as an alternative to the Northeast dairy compact. Upper Midwest producers preferred the new program to state compacts since the new program shares the price premiums nationally. Large dairy farmers expressed concern that the new program would cause excess milk production that would in turn decrease farm milk market prices. They contend that this negatively affects their income, since their annual production is well in excess of the 2.4 million lb. payment limit, and any production in excess of 2.4 million pounds receives the market price and no federal payments. (Annual production of 2.4 million pounds is roughly equal to the annual production of a herd of approximately 120 to 130 dairy cows.) The International Dairy Foods Association, a trade association representing dairy processors, was opposed to the program in its earlier version, when processors would have been required to continue paying the price premiums. However, its opposition was lifted, when the funding responsibility was shifted to the federal government as in the final version of the program.

Table 1. Monthly Milk Income Loss Contract (MILC) Payment Levels

Month	Payment (per hundredweight)	Month	Payment (per hundredweight)
December 2001	$0.77	April 2003	$1.82
January 2002	$0.78	May 2003	$1.79
February 2002	$0.78	June 2003	$1.78
March 2002	$0.93	July 2003	$1.76
April 2002	$1.00	August 2003	$1.22
May 2002	$1.09	Sept.- Dec. 2003	$0.00
June 2002	$1.20	January 2004	$0.83
July 2002	$1.38	February 2004	$0.95
August 2002	$1.45	March 2004	$0.79
September 2002	$1.45	April 2004	$0.02
October 2002	$1.59	May 2004-May 2005	$0.00
November 2002	$1.39	June 2005	$0.03
December 2002	$1.43	July-November 2005	$0.00 (*)
January 2003	$1.41	December 2005	$0.04 (*)
February 2003	$1.56	January 2006	$0.105 (*)
March 2003	$1.75		

Source: USDA, Agricultural Marketing Service (AMS)

* Legislative authority for the MILC program expired on September 30, 2005. The pending conference agreement to the FY2007 omnibus budget reconciliation bill contains a two-year extension of program authority. The payments posted in this table for December 2005 ($0.04 per cwt.) and January 2006 ($0.105 per cwt.) will be made retroactively if MILC extension is enacted in its present form in the conference agreement.

MILC Payment History

USDA began accepting applications for the "Milk Income Loss Contract (MILC) Program" on August 15, 2002 and continued to do so until the program expired on September 30, 2005, as required by the 2002 farm bill. Monthly market prices were sufficiently low between December 2001 and August 2003 that MILC payments were made in every month during this period. Beginning in the late summer months of 2003, market farm milk prices greatly improved, rebounding from a 25-year low that prevailed throughout most of the early months of 2003. Hence, no MILC payments were required in September through December 2003. However, farm milk prices began to decline again in the latter part of 2003. Consequently, MILC payments resumed in January and February 2004. Market farm milk prices reversed their course in the late winter months and early spring of 2004, increasing to record high levels by the spring of 2004. Market prices remained sufficiently high from May 2004 through May 2005 so that no MILC payments were required over that time period. Market prices declined to the point that a small MILC payment ($0.03 per cwt.) was made for June 2005 milk production, the only payment that was made in all of FY2005. If the conference agreement to the FY2006 omnibus budget reconciliation bill is enacted in its present form, retroactive payments will be made for December 2005 and January 2006. (See **Table 1** for MILC payment history.)

Federal Cost of MILC

For the three years of the MILC program, its cumulative cost was just over $2 billion — $1.8 billion in FY2003, $221 million in FY2004, and $8.8 million in FY2005. The FY2003 total actually includes two fiscal years worth of payments, since retroactive payments for FY2002 were made over the course of FY2003. FY2004 and FY2005 outlays were significantly lower than originally estimated because market farm milk prices were much stronger than originally forecasted, reaching a record high in the summer of 2004. Farm milk prices remained strong throughout all of FY2005, and MILC payments were triggered in only one month during the year (June 2005). During the first three fiscal years of the program (FY2003-FY2005), five states accounted for just over one-half of the total payments made over the time period (see **Table 2**).

Table 2. Top 20 Recipient States of MILC Payments, FY2003-2005 Cumulative Total

($ in millions)

State	FY2003-2005 Total Payments	State	FY2003-2005 Total Payments
1. Wisconsin	$415.2	11. Missouri	$39.8
2. New York	$187.0	12. Idaho	$39.1
3. Pennsylvania	$181.3	13. Illinois	$38.1
4. Minnesota	$163.6	14. Washington	$36.0
5. California	$149.1	15. Kentucky	$34.6
6. Michigan	$84.9	16. Indiana	$33.9
7. Ohio	$76.5	17. Virginia	$33.1
8. Iowa	$67.4	18. Tennessee	$27.1
9. Vermont	$45.4	19. South Dakota	$22.5
10. Texas	$45.3	20. Maryland	$20.1
20-State Total	**$1,740.1**		
U.S. Total	**$2,025.4**		

Source: U.S. Department of Agriculture, Farm Service Agency

MILC Program Reauthorization

The MILC program expired on September 30, 2005, while all other major farm commodity support programs authorized by the 2002 farm bill expire at the end of the 2007 crop year. Proponents of the MILC program would like to see the program extended to coincide with the expiration of all other commodity support programs. The conference agreement on the FY2006 omnibus reconciliation bill contains a provision (H.Rept. 109-362, S. 1932) that extends the MILC program through September 30, 2007. It also reduces the MILC payment rate so that a recipient would receive 34% of the difference between the target price and the lower market price, instead of the 45% payment rate in the recently expired program.

The payment rate was reduced as a budget-saving measure in order to keep the two-year estimated cost of program extension just below $1 billion. (CBO estimates the two-year cost of the provision at $998 million, compared with $1.2 billion if the program were extended without the payment rate reduction.) Also, in order to minimize the cost of program extension, the conference agreement reduces the MILC payment rate to 0% in September 2007, the last month of program extension. This means that when the next farm bill is formulated in 2007, the MILC program will have no baseline budget spending allocated to it beyond August 2007.

During the budget reconciliation debate, some farm groups opposed MILC program extension, since the agriculture committees had to offset its cost with reductions in other USDA mandatory programs in order to reach its budget deficit reduction targets. In its FY2006 budget request, the Administration expressed its support of a two-year extension of the MILC program in its current form. (See CRS Report RS22086, *Agriculture and FY2006 Budget Reconciliation*, by Ralph M. Chite, for more information.)

Separately, a number of free-standing bills in the 109th Congress have been introduced to extend the MILC program. No action was taken on any of these measures. H.R. 859 (C. Peterson), H.R. 1260 (Reynolds), H.R. 3847 (Green), S. 273 (Coleman), and S. 307 (Santorum), would extend the life of the MILC program for two additional years, through September 30, 2007. Two other bills would provide shorter-term extensions, until October 31, 2005 (H.R. 3848) and December 31, 2005 (H.R. 3846). In addition, a provision in H.R. 1260 and S. 273 would double the limit on eligible production for a MILC payment from the current 2.4 million lbs. to 4.8 million lbs., which is supported by larger milk producers who contend that the current production limit is set too low to benefit them. H.R. 1260 and S. 273 also would raise the payment rate for all MILC program payment recipients from the current $16.94 per cwt. to $17.10.

Dairy Price Support Program

Background and Spending

The Agricultural Act of 1949 first established the dairy price support program by permanently requiring USDA to support the farm price of milk. Since 1949, Congress has regularly amended the program, usually in the context of multi-year omnibus farm acts and budget reconciliation acts. (See **Table 3**, below, for a recent history of spending on the dairy price support program and related activities.) Most recently, Section 1501 of the Farm Security and Rural Investment Act of 2002 (P.L. 107-171, the omnibus 2002 farm bill) authorized a 5½-year extension of the program through December 31, 2007, at the then-current support price of $9.90 per hundredweight (cwt.) of farm milk.

Table 3. Commodity Credit Corporation Dairy Price and Income Support Operations, 1980/81-2004/05

Marketing Year[a]	Net Removals Milk Equivalent (billion lbs.)[b]	Net Outlays (million $)	CCC Support Price ($ per cwt.)	CCC Purchases as Percentage of Production
1980-81	12.7	1,975	13.10	9.6
1981-82	13.8	2,239	13.49-13.10	10.2
1982-83	16.6	2,600	13.10	12.0
1983-84	10.4	1,597	13.10-12.60	7.6
1984-85	11.5	2,181	12.60-11.60	8.2
1985-86	12.3	2,420	11.60	8.5
1986-87	5.4	1,238	11.60-11.35	3.8
1987-88	9.7	1,346	11.10-10.60	6.7
1988-89	9.6	712	10.60-11.10	6.7
1989-90	8.4	505	10.60-10.10	5.7
1990-91	10.4	839	10.10	7.0
1991-92	10.1	232	10.10	6.7
1992-93	7.6	253	10.10	5.0
1993-94	4.2	158	10.10	2.8
1994-95	2.9	4	10.10	1.8
1995-96	0.1	-98	10.10-10.35	0.1
1996-97	0.7	67	10.20	0.4
1997-98	0.7	291	10.20-10.05	0.4
1998-99	0.3	480 [c]	10.05-9.90	0.2
1999-2000	0.8	684 [d]	9.90	0.5
2000-01	0.3	1,140 [e]	9.90	0.2
2001-02	0.2	614	9.90	0.1
2002-03	0.5	2,494 [f]	9.90	0.3
2003-04	NA	350 [g]	9.90	NA
2004-05 [h]	NA	33	9.90	NA

Source: U.S. Department of Agriculture, Farm Service Agency, selected publications.
a. The marketing year is October 1-September 30.
b. The milk equivalent is the pounds of fluid milk used to manufacture cheese and butter, on a milkfat basis.
c. Includes $200 million in emergency "market loss" payments authorized by P.L. 105-277.
d. Includes $125 million in net outlays for market loss payments authorized by P.L. 106-78.
e. Includes $675 million in market loss payments authorized by P.L. 106-387.
f. Includes $1.8 billion in Milk Income Loss Contract payments.
g. Includes an estimated $220 million in Milk Income Loss Contract payments.
h. USDA estimate.

Historically, the supported farm price for milk is intended to protect farmers from price declines that might force them out of business and to protect consumers from seasonal imbalances of supply and demand. USDA's Commodity Credit Corporation (CCC) supports milk prices by its standing offer to purchase surplus nonfat dry milk, cheese, and butter from dairy processors. Government purchases of these storable dairy products indirectly support the market price of milk for all dairy farmers. Prices paid to the processors are set administratively by USDA at a level that should permit them to pay dairy farmers at least the federal support price for their milk.

In order to achieve the support price of $9.90 per cwt. of milk, USDA has a standing offer to processors to purchase surplus manufactured dairy products at the following prices: $1.05 per lb. for butter, $0.80 for nonfat dry milk, $1.1314 per lb. for block cheddar, and $1.1014 per lb. for barrel cheese. Whenever market prices fall to the support level, processors generally make the business decision of selling surplus product to the government rather than to the marketplace. Consequently, the government purchase prices usually serve as a floor for the market price, which in turn indirectly support the farm price of milk at $9.90 per cwt.

The dairy price support program is separate from the Milk Income Loss Contract (MILC) payments that also were authorized by the 2002 farm bill. (See the section above in this brief for more on the MILC payment program.) However, the MILC payments are considered a related activity to the price support program. Hence, MILC outlays are included in **Table 3**.)

The Administration's FY2006 Budget Proposal

In its FY2006 budget request, released on February 7, 2005, the Administration made several proposals for reducing the cost of all federal farm commodity price and income support programs over a multi-year period. As part of dairy's contribution to deficit reduction, the Administration had proposed that USDA be required to adjust the government purchase prices of surplus butter and nonfat dry milk (powder) so that government purchases and federal costs can be minimized. Under current law, USDA has the authority to adjust the butter and powder prices twice annually, which it has exercised infrequently. Whenever USDA reduces the purchase price of one product, it must increase the purchase price of the other in order to continue supporting the overall farm price of milk at the mandated level of $9.90 per cwt.

The Administration proposes the elimination of the twice a year limit on price adjustments and instead would require USDA to adjust purchase prices when surplus dairy product purchases are excessive, in order to minimize federal costs. Separately, it would prohibit USDA from purchasing any dairy products under the price support program in any month that the prior month's market price of the commodity is above the support price. The Administration estimates that its dairy proposals would save approximately $600 million over 10 years. Legislation would have to be enacted to cause any changes to the program. Neither the House nor the Senate versions of the FY2006 omnibus reconciliation bills contains any changes to the dairy price support program. Proponents say that in the long run the Administration's proposal would reduce government costs and make domestic milk products more competitive in world markets. Most dairy farmer groups oppose reductions in government purchase prices, and contend that the income of all dairy farmers would be adversely affected. The issue might resurface when the farm bill is debated next year.

Federal Milk Marketing Order Issues

Background on Federal Milk Marketing Orders

The farm price of approximately two-thirds of the nation's fluid milk is regulated under federal milk marketing orders. Federal orders, which are administered by the U.S. Department of Agriculture (USDA), were instituted in the 1930s to promote orderly marketing conditions by, among other things, applying a uniform system of classified pricing throughout the market. Some states, California for example, have their own state milk marketing regulations instead of federal rules. Producers delivering milk to federal marketing order areas are affected by two fundamental marketing order provisions: the classified pricing of milk according to its end use, and the pooling of receipts to pay all farmers a blend price.

Proponents of federal orders argue that orders are necessary because dairy farmers have a competitive disadvantage vis-a-vis dairy handlers (processors) when it comes to determining prices that farmers receive for their raw, perishable milk. Federal orders regulate handlers who sell milk or milk products within a defined marketing area by requiring them to pay not less than established minimum class prices for the Grade A milk they purchase from dairy producers, depending on how the milk is used. This classified pricing system requires handlers to pay a higher price for milk used for fluid consumption (Class I) than for milk used in manufactured dairy products such as yogurt, ice cream, and sour cream (Class II products), cheese (Class III), and butter and dry milk products (Class IV products). These differences between classes reflect the different market values for the products.

Blend pricing allows all dairy farmers who ship to the market to pool their milk receipts and then be paid a single price for all milk based on order-wide usage (a weighted average of the four usage classes). Paying all farmers a single blend price is seen as an equitable way of sharing revenues for identical raw milk directed to both the higher-valued fluid market and the lower-valued manufacturing market.

Manufactured class (Class II, III and IV) prices are the same in all orders nationwide and are calculated monthly by USDA based on current market conditions for manufactured dairy products. The Class I price for milk used for fluid consumption varies from area to area. Class I prices are determined by adding to a monthly base price, a "Class I differential" that generally rises with the geographical distance from milk surplus regions in the Upper Midwest, the Southwest, and the West. Class I differential pricing is a mechanism designed to ensure adequate supplies of milk for fluid use at consumption centers. The supply of milk may come from local supplies or distant supplies, whichever is more efficient. However, local dairy farmers are protected by the minimum price rule against lower-priced milk that might otherwise be hauled into their region.

Milk Regulatory Equity Act of 2005 (H.R. 4015, S. 2120)

On December 16, 2005, the Senate passed by unanimous consent the Milk Regulatory Equity Act (S. 2120) which addresses several federal milk marketing order issues relevant to the western United States. An identical bill (H.R. 4015) was introduced earlier in the

House, but no action has been taken. Among the milk marketing order issues addressed in H.R. 4015/S. 2120 are: 1) the regulation of fluid milk processors who operate a plant in a federal order area, are not regulated by that order, and ship packaged milk into a state marketing order (not a federal order); 2) the regulation of fluid processors who produce, package and distribute their milk, also known as producer-handlers or producer-distributors; and 3) the exclusion of Nevada from federal milk marketing orders.

Regulation of Certain Interstate Milk Shipments. H.R. 4015 and S. 2120 affect any processor (handler) of Class I (fluid-use) milk who operates a plant that is located in a federal milk marketing order area, is not regulated by the federal order because it has no sales in the federal marketing area, and has packaged fluid milk deliveries to a state that is regulated by a state marketing order. Such a plant is not currently paying a regulated price for the raw milk that is used for these dispositions or sales. The bill would require any such processor to pay into the federal order pool the minimum federal milk marketing order price for the raw milk that went into the shipments sold into the state order.

This provision would primarily affect a large fluid processor who is located in Yuma, Arizona (which is part of the Arizona-Las Vegas milk marketing order area), but ships all of its packaged milk into California. Under current law and regulations, this plant's interstate shipments to California are not regulated by either the Arizona-Las Vegas order or the California state order. This provision is supported by other processors and milk producers who contend that this processor's current exclusion from paying the minimum regulated price is a "loophole" in the current federal order system, which they say provides that processor with an unfair advantage. Opponents of this provision contend that it would adversely affect their operations and raise the price of milk to consumers. They also contend that Congress and USDA should hold hearings on the issue before any legislative changes are considered.

Producer-Handler Exemption. As defined by USDA, producer-handlers are dairy farmers who process milk from their own cows in their own plants and market their packaged fluid milk and other dairy products themselves. Producer-handlers sometimes are referred to as producer-distributors, or P-Ds. Producer-handlers may sell products directly to consumers through their own stores, directly to consumers on home-delivery routes, or to wholesale customers such as food stores, vendors, or institutions. Current regulations exempt producer-handlers from the minimum price requirements of federal milk marketing orders, but minimal reporting is required.

H.R. 4015 and S. 2120 would require the full regulation of any producer-handler with distribution of fluid milk in the Arizona-Las Vegas order area in excess of 3 million pounds in the previous month. The proposed legislation primarily would affect the same producer-handler in Arizona that would be affected by the interstate milk shipment provision discussed above. USDA has been considering regulatory changes that would establish a 3 million lb. per month route disposition limit for a producer-handler exemption, both in the Pacific Northwest and the Arizona-Las Vegas order areas. The proposed USDA regulation also would affect at least three large producer handlers in the Pacific Northwest. A final USDA decision is pending.

The producer-handler issue is a separate issue from the provision above relating to the interstate shipment of milk, but with similar implications. Producers of regulated milk want this unregulated milk to become regulated so it will increase the blend price received by all regulated dairy farmers. Regulated processors contend that it is unfair that they have to pay the regulated price while certain handlers are exempt. The producer-handlers who would become regulated argue that this is a tax being placed on independent family farms that would ultimately result in higher prices to consumers.

Nevada Exclusion from Federal Milk Marketing Orders. Section 760 of the FY2000 agriculture appropriations act (P.L. 106-78) was intended to remove Clark County, Nevada from the Las Vegas-Arizona federal milk marketing order area so that the only handler in this county would be subject to the lower Nevada state order price for fluid milk. However, the enacted provision was phrased in a way that did not completely remove Clark County from the federal order system. The enacted language exempted any plant operating in Clark County from being subject to any federal milk marketing order. However, it did not remove Clark County from the Arizona-Las Vegas milk marketing order area. This means that milk that is currently shipped from California to Clark County is partially regulated and compensatory payments to the Arizona-Las Vegas order are required. Hence, a provision in H.R. 4015 and S. 2120 would completely remove the state of Nevada from the marketing area definition of any order, which supporters say would end the required compensatory payments paid by California milk shippers and allow all of Nevada to be joined together in the state order.

Milk Protein Concentrate Trade Issues

Milk protein concentrate is a product in which certain milk proteins necessary for the production of cheese and other food products are selectively included and all or most of the water is removed from the milk, thus making it efficient to ship long distances. Dairy farmer groups are concerned that imports of MPC and casein (the main protein found in milk) are displacing domestic milk used for cheesemaking and depressing farm milk prices. Certain concentrations are not covered by tariffs or quotas under the existing World Trade Organization agreement. The importation of these products was not an issue when the agreement was formulated in the 1990s.

On March 5, 2001, the General Accounting Office released a study on the production, imports, and regulation of milk protein concentrates. The study found that MPC imports grew rapidly from 1990 to 1999 — from 805 to 44,878 metric tons, including a near doubling in 1999 over 1998 alone. According to the study, six countries (New Zealand, Ireland, Germany, Australia, the Netherlands and Canada) accounted for 95% of the 1999 imports. For the full text of the GAO study, see [http://www.gao.gov/new.items/d01326.pdf]. According to International Trade Commission data, MPC imports peaked in 2000 at 52,677 metric tons, before falling back to 28,469 metric tons in 2001, and rising again to 33,626 metric tons in 2002 and 29,111 metric tons in the first 10 months of 2003 (7.8% higher than the first 10 months of 2002). Imports of casein have also risen over the years, peaking at 74,230 metric tons in 2000, before declining in 2001 and 2002, but rising again in 2003 on a pace with the peak in 2000.

Currently, MPC is not allowed as an ingredient in any U.S. cheese which has a standard of identity defined by the Food and Drug Administration, which includes most cheese. Cheese processors petitioned FDA for a change in standards to allow MPC in cheese production. On October 19, 2005, FDA issued a proposed rule that would allow liquid ultra-filtered milk to be used in standardized cheeses. Processors say that the use of ultra-filtered milk enhances product consistency and allows for more efficient transportation of milk. This rule does not address the use of dry ultra-filtered milk (i.e, milk protein concentrate) in standardized cheese production.

Measures have been introduced in the 109th Congress (H.R. 521 and S. 1417) that would impose tariff rate quotas (TRQs) on certain MPCs. Under the proposed TRQ, any imports of MPC above the quota level would be subject to a high tariff that would economically prohibit MPC imports above that level.

Supporters of TRQs on MPC, including most milk producer groups, contend that foreign MPC and casein are being dumped in the United States. Opponents of the legislation include dairy processor groups, the largest of which is the International Dairy Foods Association (IDFA), who contend that MPC imports are not displacing U.S. production of nonfat dry milk. IDFA and other MPC-user groups contend that MPCs have certain properties that are important in the manufacturing of certain food products (e.g. high-protein sport drinks and food bars) and that nonfat dry milk is not a substitute for the use of MPCs. These groups also maintain that the domestic support price for nonfat dry milk should be reduced instead, as a way to stimulate the market for domestic powder. (For more information on the dairy price support program, see the section on the program in this brief.)

The National Milk Producers Federation (NMPF), the largest trade association representing milk producer cooperatives, has urged the federal government to examine several trade policy options for addressing the milk protein concentrate import issue. These include provisions in the Trade Act of 1974 that allow the President (following an International Trade Commission investigation) to provide relief to a U.S. industry adversely affected by imports; a 1974 Trade Act provision that allows the U.S. Trade Representative to retaliate against certain foreign trade policies; and the use of antidumping laws and countervailing measures.

On April 17, 2002, the NMPF filed a formal challenge concerning the U.S. Customs Service classification of various dairy product imports, including MPC. Under Section 516 of the Tariff Act of 1930, interested parties are permitted to challenge the tariff classification of imported items. The NMPF claims that imported MPC is not a true concentrated milk protein, but is instead a blend of other dairy products (such as nonfat dry milk, whey powder and casein). These blends, they say, "take unfair advantage of U.S. trade policies that allow the unrestricted entry of MPC, but not the individual components found in the blended products." On April 1, 2003, the Customs Service ruled that milk protein concentrates are classified correctly. It stated that the current definition of milk protein concentrate only requires that MPC's consist of at least 40% milk proteins, but does not specify whether the product is manufactured through the filtration of skim milk or the blending with nonfat dry milk or other components. The NMPF has announced an appeal of the Customs ruling, a process which could take more than one year.

As requested by the Senate Finance Committee, the International Trade Commission completed a year-long investigation of U.S. market conditions for milk proteins, and filed a written report on May 18, 2004. (See [http://hotdocs.usitc.gov/docs/pubs/332/pub3692.pdf] for the full report.) The ITC was asked to provide an overview of the global market of milk proteins, information on how government support and intervention affects the protein market, and assess how imported milk proteins affect U.S. farm milk prices. The ITC determined that imports of milk proteins may have displaced 318 million lbs. of U.S.-produced milk protein products over the 1998-2002 period, or an average of 63 million lbs. per year. The ITC states that during this period, domestic milk proteins were in surplus by a greater amount than what was likely displaced by protein imports. Therefore, they concluded that most of the impact of milk protein product imports was absorbed by the taxpayer through additional purchases of surplus nonfat dry milk, and that farm-level prices were not significantly affected. The ITC study also determined that the dairy price support program creates a disincentive to manufacture MPCs in the United States. They found that under most conditions, U.S. dairy processors could receive a higher return on the production of nonfat dry milk compared with the production of MPCs.

Legislation was introduced in the 108th Congress (H.R. 4223) that would have authorized a federal program to subsidize the domestic production of MPCs, with payment levels set at the discretion of the Secretary of Agriculture. No action was taken on the measure, and a similar bill has not been reintroduced in the 109th Congress. Supporters contend that the cost of these payments would be offset by reduced purchases of surplus nonfat dry milk. They say that manufacturers will divert production from surplus nonfat dry milk to MPCs, thus improving farm milk prices. Opponents are concerned that the proposed subsidy program might be subject to a challenge in the World Trade Organization. They also contend that even with a subsidy program, it will be difficult for domestic producers to profit in the market because foreign competitors have a greater price advantage.

Legislation

Milk Income Loss Contract (MILC) Program Extension

S. 1932 (Gregg)

Deficit Reduction Omnibus Reconciliation Act of 2005. Section 1101 of the conference agreement extends authority for Milk Income Loss Contract (MILC) payments until September 30, 2007, and reduces the payment rate to 34% of the difference between the target price for farm milk and the lower market price. Section 1101 further reduces the MILC payment rate to 0% in September 2007, effectively prohibiting any payments for that month's milk production and ensuring that the program has no baseline budget spending allocated to it when the next farm bill is formulated. Differing versions of S. 1932 were agreed to in the Senate on November 3, 2005 and in the House (originally offered as H.R. 4241) on November 18, 2005. The conference agreement (H.Rept. 109-362) was approved by the House on December 19, 2005, and by the Senate, with an amendment, on December 21, 2005.

H.R. 859 (C. Peterson), H.R. 3847 (Green), S. 307 (Santorum)

Amends the Farm Security and Rural Investment Act of 2002 to extend contracts for national dairy market loss (MILC) payments through FY2007. H.R. 859 was introduced February 16, 2005, and referred to House Agriculture Committee. S. 307 was introduced February 7, 2005, and referred to Senate Agriculture Committee

H.R. 1260 (Reynolds) S. 273 (Coleman)

Amends the Farm Security and Rural Investment Act of 2002 to (1) extend contracts for national dairy market loss payments through FY2007; (2) increase the eligible portion of a producer's milk production from the current 2.4 million lbs. to 4.8 million lbs.; and (3) raise the payment target price from the current $16.94 per hundredweight (cwt.) to $17.10 per cwt. H.R. 1260 was introduced March 10, 2005, and referred to House Agriculture Committee; S. 273 was introduced February 3, 2005, and referred to Senate Agriculture Committee.

H.R. 3846 (Green), H.R. 3848 (Green)

Extends the MILC program until December 31, 2005 (H.R. 3846) and October 31, 2005 (H.R. 3848). Both measures were introduced on September 21, 2005, and referred to the House Agriculture Committee.

***Milk Protein Concentrate Tariff- Rate Quota*s**

H.R. 521 (Sherwood), S. 1417 (Craig)

Imposes tariff-rate quotas on certain casein and milk protein concentrates. H.R. 521 was introduced February 2, 2005; referred to House Ways and Means Committee. S. 1417 was introduced July 18, 2005; referred to Senate Finance Committee.

Milk Regulatory Equity Act

H.R. 4015 (Nunes) and S. 2120 (Kyl)

Identical bills that address several federal milk marketing order issues relevant to the western United States. Among these issues are: 1) the regulation of fluid milk processors who operate a plant in a federal order area, are not regulated by that order, and ship packaged milk into a state marketing order (not a federal order); 2) the regulation of fluid processors who produce, package and distribute their milk, also known as producer-handlers or producer-distributors; and 3) the exclusion of Nevada from federal milk marketing orders. H.R. 4015 was introduced on October 7, 2005, and referred to the House Agriculture Committee. S. 2120 was introduced on December 16, 2005, and passed by unanimous consent on the Senate floor on the same day.