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Dairy Policy and the 2008 Farm Bill

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Summary

Two ongoing federal programs that support the price and income received by dairy farmers — the dairy price support program and the Milk Income Loss Contract (MILC) program — were reauthorized with modifications in the Food, Conservation, and Energy Act of 2008 (P.L. 110-234, the 2008 farm bill).

The MILC program allows participating dairy farmers to receive a government payment when the farm price of milk used for fluid consumption falls below an established target price. The enacted 2008 farm bill extends the MILC program through FY2012 at the existing level of support, but increases the payment percentage rate and the amount of eligible production. The target price also can be increased in any month that feed costs are above a certain threshold. The MILC program is supported by milk producer groups in the Northeast and the Upper Midwest. Large farmers, particularly in the West, contend that the program payment limit is biased against them. Market prices for farm milk have been substantially above the target price for more than a year, precluding the need for MILC payments.

Separately, under previous farm law, the dairy price support program indirectly supported the farm price of milk at $9.90 per hundredweight (cwt.) through government purchases of surplus dairy products from dairy processors. The 2008 farm bill extends the dairy support program through December 31, 2012, but modifies the program so that it directly supports the prices of dairy products at mandated levels. This program shift was designed to help reduce the program's exposure under World Trade Organization limitations. Most dairy farm groups and the Administration view the program as a necessary safety net in a market that is frequently characterized by volatile prices. Dairy processors consider the price support and MILC programs to operate at cross-purposes, which they say contributes to surplus milk production.

A third federal dairy pricing policy tool, federal milk marketing orders, requires dairy processors in many regions to pay a minimum price for farm milk depending on its end use. Federal orders are permanently authorized and most changes are made administratively by USDA through the rulemaking process. However, a number of federal order issues were brought to the attention of Congress for the farm bill debate. Included in the final bill is a provision that exempts dairy processors from paying the federal minimum price whenever they forward contract prices with dairy farmers. Separately, the enacted 2008 farm bill contains a provision that allows USDA to implement a 2002 farm bill-mandated assessment on imported dairy products, but reduces the import assessment to 7.5 cents per cwt. The import assessment is supported by most milk producer groups, but opposed by dairy importers and processors. (See **Appendix A** at the end of this report for a side-by-side comparison of the enacted 2008 farm bill dairy provisions with previous law and the House- and Senate-passed versions of the farm bill.)

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Overview

The Food, Conservation, and Energy Act of 2008 (P.L. 110-234, the 2008 farm bill) is the most recent omnibus farm bill, authorizing or reauthorizing a wide range of programs for a multi-year period, including commodity price and income support, farm credit, agricultural conservation, research, rural development, and foreign and domestic food programs, among others. The 2008 farm bill became law on May 22, 2008, after the House and Senate successfully voted to override a veto of the measure.

Subtitle E of the commodity programs title (Title I) of the enacted 2008 farm bill contains the authority for two major ongoing dairy policy tools used by the U.S. Department of Agriculture (USDA) to support the prices and incomes received by dairy farmers — the dairy price support program (DPSP) and the Milk Income Loss Contract (MILC) program. Previous authority for these programs was governed by the 2002 farm bill (P.L. 107-171) through 2007, and extended into May 2008 by the enactment of various short-term farm bill extensions. As part of more than one year of hearings and debate on the omnibus farm bill, Congress considered whether to reauthorize these two programs in their current forms or with modifications.

P.L. 110-234 reauthorizes the MILC program through September 30, 2012, and the DPSP through December 31, 2012, with several modifications as discussed in this report. The DPSP provides indirect price support to dairy farmers through government purchases of surplus dairy products at stated prices. The MILC program supports dairy farmer income through direct payments to participating dairy farmers when the market price of farm milk in any month falls below a legislatively mandated target price.

A third federal dairy policy tool, federal milk marketing orders, requires dairy processors to pay a minimum price for farm milk depending on its end use. Federal orders are permanently authorized and hence do not require periodic reauthorization. Instead, changes are generally made administratively by USDA and approved by farmer referendum. However, issues such as the proposed authority for processors to be exempt from federal order minimum prices processors when they forward contract with dairy farmers were brought to the attention of Congress in the farm bill debate. P.L. 110-234 authorizes a temporary forward contract program (through September 30, 2012) and contains safeguards designed to ensure that dairy farmers are not compelled by processors to participate in the program. The 2008 farm bill also authorizes a commission to review and evaluate federal milk marketing order policies and procedures.

Separately, the 2008 farm bill requires Alaska, Hawaii, and Puerto Rico to contribute to an ongoing dairy promotion program that is currently supported by mandatory assessments on dairy producers in the 48 contiguous states. This provision was included to allow USDA to implement a 2002 farm bill-mandated extension of this assessment to imported dairy products. This provision was supported by most milk producer groups, but opposed by dairy importers and processors.

See **Appendix A** at the end of this report for a side-by-side comparison of the enacted 2008 farm bill with current law and the House and Senate farm bill dairy provisions.

Milk Income Loss Contract (MILC) Program

Background

In FY1999-FY2001, Congress provided just over $32.5 billion in emergency spending for U.S. Department of Agriculture (USDA) farm commodity support programs, primarily to help farmers recover from low farm commodity prices. The majority of these funds were for supplemental direct farm payments made to producers of certain supported farm commodities, including milk. Of this amount, dairy farmers received total supplemental "market loss" payments of $1 billion over three years.

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 these emergency payments, 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 strongly opposed regional compacts.

In response, 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 was created 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. Authority for the MILC program originally expired on September 30, 2005, as required by the 2002 farm bill. However, several subsequent measures granted short-term extensions of the MILC program and many other expiring farm bill authorities, ultimately until May 23, 2008, to allow Congress to complete work on the 2008 farm bill.

2008 Farm Bill Provisions and Issues

Under the now-expired 2002 farm bill authority for the MILC program, participating dairy farmers nationwide were eligible for a federal payment whenever the minimum monthly market price for farm milk used for fluid consumption (Class I) in Boston fell below $16.94 per hundredweight (cwt.).[1] Eligible farmers then received a payment equal to 34% of the difference between the $16.94 target price and the lower monthly market price. The 2002 law required that payments be limited to the first 2.4 million pounds of annual milk production per dairy operation (which is roughly equivalent to the total annual production of a 130-cow operation).

MILC Provisions in the 2008 Farm Bill. Section 1506 of the 2008 farm bill (P.L. 110-234) extends the authority for the MILC program until September 30, 2012, and retains the base target price at $16.94 per cwt. However, the 2008 farm bill makes significant changes to the MILC payment structure in the following ways:

- ***Payment Percentage Rate Increased:*** Until September 30, 2008, a dairy producer will continue to receive a payment equal to 34% 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. However, from October 1, 2008 through August 31, 2012, the 2008 farm bill raises the payment rate to 45% of the price deficiency, which will result in a one-third larger payment to eligible farmers in months when a payment is triggered. The payment percentage rate will revert to the 34% level for the final month of the program. This reversion was included to minimize long-term budget outlays, so that the cost of increasing the percentage payment rate does not get built into the baseline budget once the program expires.

- ***Production Payment Limit Increased:*** The 2008 farm bill maintains the payment quantity limit at 2.4 million pounds through September 30, 2008, and then raises the payment limit to 2.985 million pounds of annual production (equivalent to about a 160-cow operation) between October 1, 2008, and August 31, 2012. Like the increase in the percentage payment rate, the eligible production limit will revert to its original level (2.4 million lbs.) for the last month of program authority (September 2012) so that the budget baseline for future years does not include the cost of the increase. Since the inception of the MILC program, large dairy farm operators expressed concern that the 2.4 million lb. payment limit negatively affected their income. For larger farm operations, their annual production is well in excess of the limit, and any production in excess of that receives no federal payments. An increase was not part of the House-passed version of the bill, and the final level of 2.985 million lbs. is below the Senate-passed level of 4.15 million lbs.

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[1] A hundredweight (or one hundred pounds) of milk is roughly equivalent to 11.6 gallons of milk.

- ***Payment Level Feed-Price Adjustment:*** Because of the rapidly rising cost of feed, some dairy farm groups had sought some type of adjustment to federal dairy support programs to soften the impact. The final 2008 farm bill includes a provision that adjusts upward the $16.94 target price in any month when feed prices are above a certain threshold. The law requires USDA to calculate monthly a National Average Dairy Feed Ration Cost based on a formula that USDA currently uses to calculate feed costs. In any month that the average feed cost is above $7.35 per cwt., the $16.94 target price will be increased by 45% of the difference between the monthly feed cost and $7.35. To reduce budget exposure, the threshold feed cost will rise to $9.50 per cwt., effective for the last month of the program (September 2012).

CBO Cost Estimates. The Congressional Budget Office (CBO) estimates that the increase in the percentage payment rate to 45%; the increase in the payment limit to 2.985 million lbs. of annual production; and the institution of a new feed cost adjuster will together add $395 million to the cost of the MILC program over the five-year authorization period (FY2008-FY2012). This budget scoring is based on the March 2007 CBO baseline, which is the official benchmark for the scoring of the 2008 farm bill. When scored against the more recent CBO baseline (March 2008), the changes in the MILC program would increase MILC programs costs by a smaller amount ($105 million over five years), since projected milk market prices are now expected to remain above the target MILC price for most of the five-year period.

Administration and Industry Positions. The Administration supported a continuation of MILC payments at the current target price of $16.94 per cwt. and the 2.4 million lb. payment cap. However, in order to defray the cost of MILC program extension, the Administration recommended that the percentage payment rate be gradually reduced over a five-year period to 20% by FY2013. The Administration also wanted to base payments on historical production rather than current production in order to forestall potential challenges to the program in the World Trade Organization (WTO).

The National Milk Producers Federation (NMPF), the largest trade association representing dairy farmer cooperatives, also supported a direct payment program for farmers. In order to make the program less susceptible to challenges in the WTO, NMPF initially proposed making direct payments of $0.50 per cwt. to dairy farmers (regardless of the level of market prices) on the average production level of 2005 and 2006, up to $40,000 per farm.

The International Dairy Foods Association (IDFA), the largest trade association of dairy processors, opposed extension of the MILC program, contending that it works at cross purposes with the dairy price support program and contributes to the overproduction of milk and to high government costs. Instead, IDFA proposed a dairy farm revenue insurance program that it said would provide a better safety net for farmers without distorting milk markets.

MILC Payment History

USDA began accepting applications for the original MILC Program on August 15, 2002. (See **Table 1** for MILC payment history.) In September 2007, farm milk prices set a record high as the Class I Boston farm milk price reached $25.16 per cwt., which is $9.22 above the $16.94 per cwt. target price. For the latter half of 2007 and the first half of 2008, farm milk prices have remained well above the MILC trigger price, precluding the need for any MILC payments.

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

Month	Payment (per hundredweight)	Month	Payment (per hundredweight)
December 2001	$0.77	January 2004	$0.83
January 2002	$0.78	February 2004	$0.95
February 2002	$0.78	March 2004	$0.79
March 2002	$0.93	April 2004	$0.02
April 2002	$1.00	May 2004-May 2005	$0.00
May 2002	$1.09	June 2005	$0.03
June 2002	$1.20	July-November 2005	$0.00
July 2002	$1.38	December 2005	$0.04
August 2002	$1.45	Jan.-Feb. 2006	$0.105
September 2002	$1.45	March 2006	$0.41
October 2002	$1.59	April 2006	$0.84
November 2002	$1.39	May 2006	$0.925
December 2002	$1.43	June 2006	$1.00
January 2003	$1.41	July 2006	$0.80
February 2003	$1.56	August 2006	$0.925
March 2003	$1.75	September 2006	$0.965
April 2003	$1.82	October 2006	$0.43
May 2003	$1.79	November 2006	$0.44
June 2003	$1.78	December 2006	$0.43
July 2003	$1.76	January 2007	$0.03
August 2003	$1.22	February 2007	$0.10
Sept.- Dec. 2003	$0.00	Mar 2007-June 2008	$0.00

Source: USDA, Agricultural Marketing Service (AMS).

Table 2. MILC Payments Ranked by State, FY2003-FY2007

	FY2003	FY2004	FY2005	FY2006	FY2007	Total
Wisconsin	$372,042,880	$41,754,746	$1,369,537	$71,838,550	$23,906,505	510,912,218
New York	169,423,978	17,222,870	383,632	32,257,023	10,605,556	229,893,059
Pennsylvania	160,673,846	19,263,582	1,352,555	27,082,715	10,659,170	219,031,867
Minnesota	147,400,075	15,946,997	286,412	27,169,579	9,941,499	200,744,562
California	122,764,930	25,142,045	1,186,734	34,913,717	10,878,010	194,885,436
Michigan	75,828,865	8,799,034	316,507	15,563,328	5,234,795	105,742,529
Ohio	68,772,479	7,550,599	194,479	11,922,216	4,117,464	92,557,237
Iowa	60,686,427	6,512,172	236,348	11,629,909	4,216,210	83,281,065
Texas	38,793,821	6,282,787	199,362	9,024,192	2,833,816	57,133,978
Vermont	40,826,421	4,389,019	138,325	8,126,455	2,358,159	55,838,379
Idaho	33,211,800	5,496,523	371,276	8,719,484	1,699,743	49,498,825
Missouri	36,267,942	3,426,748	128,206	6,204,901	1,954,645	47,982,442
Illinois	34,170,687	3,818,084	158,274	6,144,976	2,098,120	46,390,142
Washington	30,869,213	5,064,507	111,841	7,539,782	1,855,240	45,440,583
Indiana	30,180,470	3,510,016	214,743	5,255,495	1,548,957	40,709,680
Kentucky	31,094,215	3,364,755	96,648	4,508,582	1,553,071	40,617,271
Virginia	29,876,611	2,895,202	324,527	5,174,178	1,588,842	39,859,361
Tennessee	24,469,076	2,545,783	62,281	3,853,946	1,389,069	32,320,156
South Dakota	20,355,578	2,148,893	31,015	3,738,836	1,073,656	27,347,977
Maryland	18,132,857	1,774,254	161,405	3,184,670	919,536	24,172,721
Oregon	16,295,432	2,178,087	35,910	4,036,387	1,163,919	23,709,736
Utah	15,782,707	2,027,249	-18,216	3,419,809	742,235	21,953,784
Georgia	15,764,327	1,930,999	31,078	3,136,152	1,041,666	21,904,223
Kansas	15,747,021	1,775,859	57,526	2,765,443	822,813	21,168,662
North Carolina	15,395,265	1,766,672	35,218	2,764,319	662,802	20,624,275
Nebraska	14,835,308	1,588,040	121,518	2,544,254	857,155	19,946,274
Puerto Rico	12,388,197	4,222,742	381,336	966,771	1,006,833	18,965,879
New Mexico	11,493,657	2,825,129	127,273	3,354,332	1,095,265	18,895,657
Oklahoma	12,519,405	1,307,138	50,983	1,958,338	597,487	16,433,350
Louisiana	11,430,924	1,066,703	31,415	1,517,821	449,378	14,496,240
Florida	9,783,286	1,761,420	31,601	2,342,573	677,334	14,596,214
Maine	10,250,302	984,845	13,481	1,904,303	585,737	13,738,668
Colorado	8,754,312	1,537,030	52,001	2,051,322	595,154	12,989,820
Arizona	7,641,285	1,526,600	163,838	2,138,679	540,790	12,011,193
North Dakota	8,964,621	1,111,814	56,389	1,291,575	514,520	11,938,920
Mississippi	8,916,963	880,166	66,520	1,189,543	370,512	11,423,703
Arkansas	7,499,823	665,206	27,202	1,011,333	242,656	9,446,219
Massachusetts	6,877,027	625,496	8,973	1,113,219	294,619	8,919,334
Connecticut	6,143,097	699,449	8,509	1,145,967	307,292	8,304,314
New Hampshire	5,095,796	515,693	11,031	973,494	306,335	6,902,350
Montana	4,901,714	519,903	21,112	1,023,945	239,646	6,706,320
South Carolina	4,779,476	529,781	52,581	914,359	275,777	6,551,974
Alabama	4,286,766	512,368	3,719	593,777	131,026	5,527,655
West Virginia	3,942,927	459,851	13,707	614,441	173,187	5,204,113
New Jersey	4,012,708	373,719	2,101	596,928	233,424	5,218,879
Nevada	2,014,582	351,358	25,597	589,067	56,619	3,037,224
Delaware	1,768,299	184,425	2,947	310,154	132,339	2,398,163
Wyoming	1,015,120	101,807	2,655	205,252	50,521	1,375,356
Hawaii	407,366	117,018	46,913	52,150	13,763	637,210
Rhode Island	451,901	36,430	390	58,558	24,271	571,550
Alaska	350,368	26,291	358	35,340	14,114	426,472
Virgin Islands	100,347	7,723	83	8,682	0	116,835
TOTAL	**1,795,452,502**	**221,125,627**	**8,789,854**	**350,480,820**	**114,651,255**	**2,490,500,058**

Federal Cost of MILC

Over the more than five years of MILC program payment authority, its cumulative cost has been just under $2.5 billion — $1.8 billion in FY2003, $221 million in FY2004, $8.8 million in FY2005, $350.5 million in FY2006, $114.7 million in FY2007, and no outlays in FY2008 to date. The FY2003 total includes two fiscal years worth of payments, since retroactive payments for FY2002 were made over the course of FY2003. Five states have accounted for just over one-half of the total payments made over the time period (see **Table 2**).

Dairy Price Support Program

The Agricultural Act of 1949 first established the dairy price support program (DPSP) 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** for a recent history of spending on the dairy price support program and related activities.) 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. Several measures were enacted to provide short-term extensions of many expiring USDA programs, including the DPSP, so that Congress could complete work on a new farm bill.

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 price of milk for all dairy farmers. Under the 2002 farm bill, prices paid to the processors were set administratively by USDA at a level that would 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 that were administratively established by USDA: $1.05 per pound for butter, $0.80 for nonfat dry milk, $1.13 per pound for block cheddar, and $1.10 per pound 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 supports the farm price of milk at $9.90 per cwt.

Government purchases of surplus dairy products have been relatively small since late 2003, as market prices have remained above the support price during that period. In the early 1980s, the support price was $13.10 per cwt. and government purchases peaked at $2.6 billion in 1983. A gradual decline in the support price to $9.90 has significantly reduced the cost of the program from peak levels

Table 3. Dairy Price Support Purchases and Costs, 1980/81-2006/07

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	280	10.05-9.90	0.2
1999-2000	0.8	569	9.90	0.5
2000-01	0.3	465	9.90	0.2
2001-02	0.2	622	9.90	0.1
2002-03	0.5	699	9.90	0.3
2003-04	NA	74	9.90	NA
2004-05	NA	- 104	9.90	NA
2005-06	NA	60	9.90	NA
2006-07	NA	22	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.

NA = Not Available

2008 Farm Bill Provisions and Issues

Section 1501 of the enacted 2008 farm bill (P.L. 110-234) extends the dairy support program for five years (through December 31, 2012), but modifies the program so that it directly supports the prices of manufactured dairy products at mandated levels. The 2008 farm bill renames the program the Dairy Product Price Support Program and requires USDA to purchase products at the following minimum prices: block cheese, $1.13/lb.; barrel cheese, $1.10/lb.; butter, $1.05/lb.; and nonfat dry milk, $0.80/lb. Under previous law, the support price for farm milk was statutorily set at $9.90 per cwt., and USDA was given the administrative authority to establish a combination of dairy product purchase prices that indirectly supported the farm price of milk at $9.90. Although the 2008 law does not specifically state that the overall support price is $9.90 per cwt, each of the mandated product prices in the law is equivalent to the current product purchase prices, so farm milk prices effectively will continue to be supported at $9.90.

The shift to a mandated product price support program was based on a proposal submitted by the National Milk Producers Federation (NMPF), which contended that the previous discretion given to USDA to establish purchase prices has "undermined the program's effectiveness."[2] NMPF also contends that a shift to a dairy product price support program would be viewed as less trade distorting in the WTO than the previous support program. (See "WTO Implications," below.)

In order to minimize program costs and the potential accumulation of excess inventories, the 2008 farm bill allows USDA to temporarily reduce the mandated prices when government purchases of a product exceed a certain specified level. The law allows USDA to reduce (1) the cheese purchase price by up to $0.10 per lb. when government purchases for a consecutive 12-month period are between 200 million and 400 million lbs, and up to $0.20 per lb when purchases exceed 400 million lbs.; (2) the butter purchase price by $0.10 per lb. when 12-month butter purchases are between 450 million and 600 million lbs, and up to $0.20 per lb. when purchases exceed 650 million lbs.; and (3) the nonfat dry milk purchase price by $0.05 per lb. when 12-month nonfat dry milk purchases are between 600 million and 800 million lbs., and up to $0.10 per lb. when purchases exceed 800 million lbs. Also, at any time, USDA can sell inventoried dairy products at prevailing market prices, as long as the selling price is at least 120% of the supported price.

In its farm bill proposal, the Administration supported the extension of the dairy price support program, viewing it as a low-cost stabilizing influence on farm milk prices. It stated that many dairy producers see the need for a floor to be kept under farm milk prices to maintain an adequate milk supply and provide a safety net. Dairy processor groups have expressed concern that the dairy price support program in combination with MILC payments work at cross-purposes, by artificially stimulating milk production and causing persistent surpluses. They also question whether having the government as a guaranteed buyer of surplus products discourages investment to

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[2] See p. 4 of "National Dairy Policy Direction: NMPF's 2007 Farm Bill Package," at [http://www.nmpf.org/files/file/NMPF%20Policy%20Direction.pdf].

produce dairy ingredients (e.g., milk protein concentrates) that are increasingly in demand in the market.

WTO Implications. Separately, some policymakers have been concerned that because of the way domestic price support programs are viewed under our trade obligations in the World Trade Organization (WTO), modifications to dairy support might be required under a new trade agreement. Although federal outlays for the dairy price support program have been relatively small (under $100 million) in recent years (see **Table 3**), the WTO measures the level of support differently.

Under current U.S. trade obligations, the aggregate measure of support for dairy is based on how much higher the domestic support price is set above a fixed world reference price (established in the WTO at a fixed level of $7.25 per cwt.). The imputed subsidy of $2.65 per cwt. (i.e., the $9.90 domestic support price less the $7.25 reference price) is applied to all domestic milk production. Using this formula, the United States has notified the WTO that the aggregate measure of support for the dairy price support program is more than $4.8 billion annually; and it is classified as "amber box," or the most trade-distorting category. The current U.S. proposal in the Doha Round is to reduce its total amber box support from the current $19.1 billion to $7.6 billion. With dairy support representing such a large percentage of the proposed new maximum, some have expressed interest in shifting future policy away from price support to some type of WTO-compliant direct payment that is decoupled from price and production. Supporters of the shift to a dairy product price support program maintain that, under the revised program, only the portion of milk production that goes into the production of the supported products would have to be notified to the WTO, and that fluid-use milk and milk used for unsupported manufactured products such as yogurt and ice cream would be exempt.

Federal Milk Marketing Orders

Background

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.

Federal orders regulate dairy handlers (processors) 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.

Proponents of federal orders argue that orders are necessary because dairy farmers have a competitive disadvantage vis-à-vis dairy handlers (processors) when it comes to determining prices that farmers receive for their raw, perishable milk. Critics contend that federal orders are arcane and outdated, and that the complexity of the system places dairy processors at a competitive disadvantage in the market.

2008 Farm Bill Provisions and Issues

Dairy Forward Contracting. A forward contract is a cash market transaction in which a seller agrees to deliver a specific commodity to a buyer at some point in the future at a mutually agreed to price. A dairy farmer and a proprietary milk handler[3] theoretically can engage in a forward contract, whereby the farmer would deliver milk to the processor at an agreed to price and future date of delivery. However, under current statute, if the monthly federal milk marketing order minimum price is above the forward contract price, the handler is still required to pay at least the federal order price for the milk. Proprietary handlers, therefore, have little incentive to enter into forward contracts, since they are prohibited from paying a price less than the federal milk marketing order minimum price. A pilot dairy forward pricing program was authorized by the FY2000 omnibus appropriations act, which USDA implemented from mid-2000 until its required expiration date of December 31, 2004.[4]

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[3] A proprietary handler is a milk processing company that is owned privately or publicly by investors other than milk producers. This structure differs from a cooperative, which is owned and operated by its farmer members.

[4] For more information on the pilot program, see the USDA Agricultural Marketing Service (continued...)

2008 Farm Bill Provisions. Section 1502 of the enacted 2008 farm bill authorizes a dairy forward pricing program that is to be administered in a similar manner as the temporary pilot program in 2000-2004. Like the original pilot program, the forward pricing program allows dairy farmers and cooperatives to voluntarily enter into forward contracts with milk handlers. Any payments made by milk handlers under the contract will be deemed to satisfy the minimum price requirements of federal milk marketing orders. The program applies only to milk purchased for manufactured products (Classes II, III, and IV), and therefore does not include milk purchased for fluid consumption (Class I). The provision allows new contracts to be entered into until September 30, 2012, but no contract can extend beyond September 30, 2015.

Dairy processor groups, primarily the International Dairy Foods Association, sought this provision so that proprietary handlers could be exempt from the minimum pricing requirements of federal orders when they enter into a forward contract with dairy farmers. Proponents contend that proprietary handlers should have the same ability to forward contract as dairy cooperatives. (Under current law, dairy cooperatives are exempt from having to pay the federal order minimum prices to its members.) They also maintain that forward pricing is an effective risk management tool for both farmers and processors, allowing them to insulate themselves from the volatility of farm milk prices. Critics, including the National Milk Producers Federation, were concerned that handlers might compel small farmers to participate in a contract, and possibly use the contract as a means of undermining the federal order pricing system.

Streamlining Rulemaking Procedures. Unlike the dairy price support program and the milk income loss contract program, federal milk marketing orders are permanently authorized and therefore do not require periodic reauthorization by Congress. Instead, changes to federal milk marketing orders are handled administratively by USDA's Agricultural Marketing Service. The authorizing statute for federal milk marketing orders requires USDA to use formal rulemaking procedures to make changes to orders. Any interested party can petition USDA to create a new order or amend an existing one. The terms of a new or amended order are developed through public participation (producers, processors and consumers) in hearings held by USDA prior to the issuance of the order. USDA analyzes the hearing records and then recommends the terms and provisions of milk marketing orders. If two-thirds of the voting producers approve a new or an amended marketing order, the Secretary then approves and issues the order.

Some dairy producer groups have expressed concern that this rulemaking procedure can take many months and sometimes years to reach a conclusion and that the process needs to be streamlined. USDA admits that the process is time consuming, but counters that it provides for maximum industry participation and transparency. The International Dairy Foods Association (IDFA) contends that the rulemaking process prevents dairy farmers and processors from competing with other food and beverage industries that are not faced with government intervention. IDFA

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[4] (...continued)
website at [http://www.ams.usda.gov/dairy/for_contr_pilot.htm].

considers federal milk marketing orders to be outdated and unresponsive to market forces, and proposed that Congress establish a blue ribbon commission of stakeholders and experts to review the federal order system in its entirety.[5]

2008 Farm Bill Provisions. Section 1504 of the enacted 2008 farm bill contains several revisions to federal order amendment procedures that include time limits for USDA to take specific actions. Section 1509 includes the authorization of a blue ribbon commission to examine the future and efficacy of federal milk marketing orders.

Dairy Import Assessment

The Dairy Producer Stabilization Act of 1983 (7 U.S.C. 4501-4514) authorized a national dairy producer program for generic dairy product promotion, research, and nutrition education. The program is funded through a mandatory 15-cent per hundredweight assessment on all milk produced and marketed in the 48 contiguous states. Section 1505 of the 2002 farm bill (P.L. 107-171) amended the 1983 act requiring that the 15-cent assessment be collected on all imported dairy products. Section 1505 also required USDA to consult with the Office of the U.S. Trade Representative (USTR) before implementing the assessment on imports to ensure that the new requirement is consistent with U.S. international trade obligations. After consulting with the USTR, the Secretary of Agriculture determined that a mandatory dairy import assessment is not permissible, since Alaska and Hawaii are exempt from the domestic assessment. According to USDA, the exemption treats some domestic producers more favorably than importers, thereby violating U.S. trade obligations. Hence, USDA has never implemented the import assessment.

2008 Farm Bill Provisions. Section 1507 of the enacted 2008 farm bill adopts the Administration's proposal to ensure that the current 15-cent assessment applies to Alaska, Hawaii and Puerto Rico. The Administration contends that the statutory change would make the definition of the United States consistent with the definition used by the USTR and U.S. trading partners, thus allowing them to implement the assessment in imported products. The enacted 2008 farm bill also reduces the assessment on imports from 15 cents to 7.5 cents.

The import assessment is supported by most dairy producer groups. However, milk producers in Alaska and Hawaii were opposed to any definition change that required them to contribute to the program. Dairy importers and processors are opposed to the import assessment, contending that it is an unfair tax on imported products which they say could be challenged as trade distorting in the World Trade Organization, regardless of whether Alaska and Hawaii are included.

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[5] See page 22 of the International Dairy Foods Association's Blueprint for the 2002 Farm Bill, "Ensuring a Healthy U.S. Dairy Industry" at [http://www.healthydairyindustry.org].

Appendix A. Summary of Major Dairy Provisions in the Enacted 2008 Farm Bill: Comparison with Previous Law and House- and Senate-Passed Bills

PREVIOUS LAW/POLICY	HOUSE-PASSED FARM BILL (H.R. 2419)	SENATE-PASSED SUBSTITUTE AMENDMENT (H.R. 2419)	ENACTED 2008 FARM BILL (P.L.110-234)
Dairy Price Support Program			
Mandatory support for farm price of milk at $9.90 per hundredweight (cwt.). Program authority expired on December 31, 2007, but was extended into May 2008 by the enactment of various short-term farm bill extensions. ***[7 U.S.C. 7981a-c]***	Mandates the direct support of cheese, nonfat dry milk, and butter at specified prices for five years (through December 31, 2012). This is a change from supporting the farm price of milk. ***[Secs. 1401(a)-(b)]***	Similar to the House bill. ***[Secs. 1601(a)-(b)]***	Adopts the House provision. ***[Sec. 1501(b)]***
Farm support price of $9.90 indirectly maintained by USDA offer to purchase butter, cheese, and nonfat dry milk from processors at prices determined by USDA that allow buyers to pay farmers at least the support price. ***[7 U.S.C. 7981a-c]***	Specifies minimum purchase prices of: block cheese, $1.13/lb.; barrel cheese, $1.10/lb.; butter, $1.05/lb.; and nonfat dry milk, $0.80/lb (same levels currently used to support the farm price at $9.90 per cwt.) Allows USDA sale of acquired products when market prices rise to 110% of purchase price. ***[Sec. 1401(b)]***	Similar to the House bill. ***[Secs. 1601(b)-(c)]***	Adopts the House provision. ***[Sec. 1501(c)]***
No more than twice annually, USDA can adjust the purchase prices of butter and nonfat dry milk (reduce one and raise the other) in order to minimize acquisitions. ***[7 U.S.C. 7981d]***	Allows a temporary reduction of mandated purchase prices when USDA acquisitions of surplus dairy products exceed specified levels. ***[Sec. 1401(c)]***	No comparable provision.	Adopts the House provision. ***[Sec. 1501(d)]***
Milk Income Loss Contract Payments			
The 2002 farm bill mandated a new counter-cyclical payment program, the Milk Income Loss Contract (MILC) program. When the monthly fluid milk price falls below $16.94/cwt., all dairy farmers are paid an amount equal to 34%	Extends the MILC program for five years, through September 30, 2012, at the current target price of $16.94/cwt. Payment rate remains at 34% of any deficiency between the market price and the target price, and eligible production	Increases, through August 31, 2012, the payment rate to 45%, and raises the cap on eligible annual production to 4.15 mil. lbs. per farm. Payment rate and production cap would return to 34% and 2.4 mil. lbs. for the last month of	Extends the MILC program through September 30, 2012 and maintains the target price at $16.94. Until October 1, 2008, payment percentage rate continues at 34%, and production payment limit at 2.4 million lbs. From October 1, 2008

PREVIOUS LAW/POLICY	HOUSE-PASSED FARM BILL (H.R. 2419)	SENATE-PASSED SUBSTITUTE AMENDMENT (H.R. 2419)	ENACTED 2008 FARM BILL (P.L.110-234)
of the difference between $16.94 and the lower market price. Payments per farm are limited to 2.4 million lbs. of annual production. MILC authority expired Sept. 30, 2005, but was extended into May 2008 by the enactment of various short-term extensions. ***[7 U.S.C. 7982]***	continues to be capped at 2.4 mil. lbs. per farm per year. ***[Sec. 1406]***	program authority in September 2012. ***[Sec. 1602]***	through August 31, 2012, the rate is increased to 45% and the limit to 2.985 million lbs. Reverts to 34% and 2.4 million lbs. for September 2012. The $16.94 target can be adjusted in any month that feed costs are higher than a specified level. ***[Sec. 1506]***
Dairy Forward Pricing Program			
The FY2000 omnibus appropriations act authorized a pilot dairy forward pricing program implemented from mid-2000 until its required expiration date of December 31, 2004. It exempted handlers from having to pay farmers the federal order price when the forward contract price turns out to be lower. ***[7 U.S.C. 627]***	Authorizes a dairy forward pricing program similar to the pilot program of 2000-2004. Price paid by milk handlers under the contracts are deemed to satisfy the minimum price requirements of federal milk marketing orders. Applies only to milk purchased for manufactured products (Classes II, III, and IV), and excludes milk purchased for fluid consumption (Class I). Allows for new contracts until September 30, 2012, but no contract can extend beyond September 30, 2015. ***[Sec. 1402]***	Similar to the House bill. ***[Sec. 1606]***	Adopts the House provision. ***[Sec. 1502]***
Dairy Export Incentive Program			
Provides cash bonus payments to U.S. dairy exporters, subject to World Trade Organization obligations to limit export subsidies. No DEIP bonuses have been awarded since FY2004. Program authority was extended into May 2008 by the enactment of various short-term farm bill extensions. Intended to counter foreign (mostly EU) dairy subsidies. ***[15 U.S.C. 713a-14(a)]***	Extends DEIP through December 31, 2012, with a reference to the Uruguay Round Agreements Act. ***[Sec. 1403]***	Extends DEIP through December 31, 2012. ***[Sec. 1603(a)]***	Adopts the House provision. ***[Sec. 1503]***

PREVIOUS LAW/POLICY	HOUSE-PASSED FARM BILL (H.R. 2419)	SENATE-PASSED SUBSTITUTE AMENDMENT (H.R. 2419)	ENACTED 2008 FARM BILL (P.L.110-234)
Dairy Indemnity Program			
Authorizes payments to dairy farmers when a public regulatory agency directs removal of their raw milk from the market because of contamination by pesticides, nuclear radiation or fallout, or toxic substances and other chemical residues. Program authority was extended into May 2008 by the enactment of various short-term farm bill extensions. ***[7 U.S.C. 450l]***	Extends the Dairy Indemnity Program through December 31, 2012. ***[Sec. 1405]***	Similar to the House bill. ***[Sec. 1603(b)]***	Adopts the House provision ***[Sec. 1505]***
Dairy Promotion and Research Program			
The Dairy Producer Stabilization Act of 1983 authorized a generic dairy product promotion, research, and nutrition education program, funded by a mandatory 15¢/cwt assessment on milk produced/marketed in the 48 contiguous states. Assessment extended to imports by Sec. 1505 of 2002 farm bill. Import assessment never collected because the exclusion of some states was considered inconsistent with WTO rules. Program authority was extended into May 2008 by the enactment of various short-term farm bill extensions. ***[7 U.S.C. 4501-4514]***	Extends promotion and research program authority through Sep. 30, 2012. Amends the 1983 Act to require producers in all 50 states, the District of Columbia, and Puerto Rico to pay the 15¢/cwt. assessment. ***[Sec. 1407]***	Extends program authority through Sep. 30, 2012. Does not address the issue involving the import assessment. ***[Sec. 1604]***	Adopts the House provision. Also reduces the assessment to be paid by importers to 7.5¢/cwt. Authorizes USDA to issue regulations on time and method of importer payments. ***[Sec. 1507]***
Federal Milk Marketing Orders			
Federal milk marketing order rules issued by USDA place requirements on the first buyers or handlers of milk, including	Creates a Federal Milk Marketing Order Review Commission to review and evaluate the current federal and similar	Creates a Federal Milk Marketing Order Review Commission, with same overall functions and purposes as the House bill,	Creates a Federal Milk Marketing Order Review Commission with 14 members appointed by USDA. Objectives of the

PREVIOUS LAW/POLICY	HOUSE-PASSED FARM BILL (H.R. 2419)	SENATE-PASSED SUBSTITUTE AMENDMENT (H.R. 2419)	ENACTED 2008 FARM BILL (P.L.110-234)
paying at least minimum prices for the milk depending on its end use. Permanent federal authority to regulate the handling of milk was first provided in the Agricultural Adjustment Act of 1933, and subsequently revised by the Agricultural Marketing Agreement Act of 1937, as amended. ***[7 U.S.C. 601 et seq.]***	state order systems. The 18-member Commission is to consider legislative and administrative options for: ensuring the competitiveness of farmers and processors, and simplifying and streamlining the federal order system. Report is due within two years of the first meeting. ***[Sec. 1409]***	but with some differences in the appointment of members and issues to be studied. ***[Sec. 1608]***	commission are similar to but modified from the House version. ***[Sec. 1509]***
When USDA amends federal orders, it must issue a notice of a hearing at least three days prior to the hearing. ***[7 U.S.C. 608c(17)]***	Revises order amendment procedures by placing time constraints on USDA at various steps of the amendment process. ***[Sec. 1404]***	Also revises amendment procedures by establishing a timetable for certain actions, but with some differences. ***[Sec. 1605]***	Includes elements of both bills with regard to the time constraint provisions, avoidance of duplication, and use of feed and fuel costs for hearings involving adjustments to make allowances. ***[Sec. 1504]***
In late April 2007, USDA announced an error in nonfat dry milk prices reported to them by manufacturers over the previous 12 months. The error contributed to lower farm milk prices than would otherwise have been the case.	Requires USDA, within 90 days of enactment, to submit a report to Congress on price reporting procedures for nonfat dry milk, and the effect these procedures have had on marketing order pricing since July 1, 2006. ***[Sec. 1408]***	Similar to the House bill, except that the report is to be filed with the House and Senate Agriculture Committees. ***[Sec. 1607)***	Adopts the Senate provision. ***[Sec. 1508]***
Mandatory Dairy Commodity Price Reporting			
Dairy Market Enhancement Act of 2000 requires manufacturers to report to USDA the price, quantity, and moisture content of dairy products sold. ***[7 U.S.C. 1637b]***	No comparable provision.	Requires manufacturers to report sales transactions daily. Requires USDA to publish the data each reporting day and compare it with other dairy market statistics on a quarterly basis. ***[Secs. 1609 and 1610]***	Authorizes USDA to establish an electronic reporting system (subject to available funds), after which increased frequency in mandatory reporting of dairy product sales would be required. Provides for quarterly audits of submitted information and comparison with related dairy market statistics. ***[Sec. 1510]***