



Dairy Market and Policy Issues

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Summary

In 2009, U.S. dairy producers have been caught in a classic “price-cost squeeze,” with farm milk prices declining sharply from record highs while feed costs remain high. From January through September 2009, the all-milk price received by farmers was 36% below a year earlier, when prices were near a record high. Meanwhile, feed costs, as measured by alfalfa prices, were down only 20% from a year earlier.

Declining milk and dairy product prices in late 2008 and early 2009 reactivated government programs to support dairy prices and dairy farm income. During this period, after several years of relative inactivity, the dairy price support program resumed purchases of surplus dairy products as prices approached support levels. The U.S. Department of Agriculture (USDA) estimates that it removed 111 million pounds of nonfat dry milk in 2008 and expects to remove 379 million pounds in 2009, along with small amounts of butter and cheese. In February 2009, milk prices declined below the trigger for Milk Income Loss Contract (MILC) payments to dairy farmers for the first time in two years. Payments have been triggered in all subsequent months to date, totaling \$775 million as of October 26.

The deteriorating economic picture has prompted calls for policymakers to consider how well current dairy policies are assisting dairy producers and what other options might be available. Throughout 2009, the National Milk Producers Federation (NMPF), the largest trade association representing milk producer cooperatives, has requested that USDA take steps to assist dairy producers. Members of Congress have also engaged the Secretary of Agriculture. On May 22, 2009, USDA restarted the Dairy Export Incentive Program to help remove excess dairy products from the market. On July 31, 2009, USDA announced a temporary increase in price support for cheese and nonfat dry milk. Since then, Congress has considered additional support for dairy farmers. In October, Congress passed the conference agreement for the FY2010 agriculture appropriations bill, which includes an extra \$350 million for emergency dairy assistance (\$60 million to purchase dairy products and \$290 million in direct payments to farmers). The bill was enacted on October 21, 2009.

Given the economic climate, producers are making business choices that are expected to reduce milk production and lift prices. However, the full effect of those decisions is underway, raising the question of what, if any, policy changes are needed. Options to address the current dairy market situation include (1) keeping the status quo and allowing remaining programs to operate, (2) implementing a new program such as a dairy buyout, and (3) modifying existing programs to enhance dairy farmer income.

Proponents of keeping the status quo argue that current dairy programs—specifically the dairy product price support program and the MILC program—already encourage additional milk production, and that more production-related support will slow the supply adjustment process needed to bring the dairy market back into balance. At any rate, any proposals that involve new budgetary outlays could be challenged as adding to an already large federal deficit, and/or burdening consumers with higher costs. Proponents of additional action point out that many producers are facing significant income loss and that without additional assistance, they may not survive financially. Producer groups and processors alike want to increase demand as a way to bolster milk and dairy product prices.

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Introduction

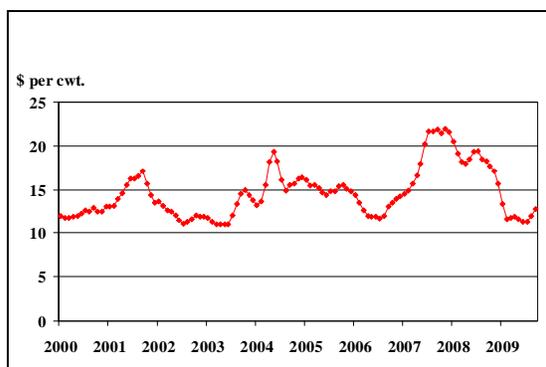
U.S. dairy producers are caught in a classic “price-cost squeeze,” with farm milk prices declining sharply from record highs while feed costs remain high. From January through September 2009, the all-milk price received by farmers was 36% below a year earlier. (The all-milk price is the weighted average farm price of fluid-grade and manufacturing-grade milk produced.) Meanwhile feed costs, as measured by alfalfa prices, were down only 20% from a year earlier.¹ The deteriorating economic picture has prompted calls for policymakers to consider how well current dairy policies are assisting dairy producers and what other options might be available.

Market Situation

The dairy market since 2007 illustrates how an agricultural boom can turn into a bust. Dairy farmers enjoyed excellent returns in 2007 and most of 2008 as strong demand pushed up the price of dairy products and the farm price of milk. In November 2007, the all-milk price hit a record \$21.90 per hundredweight (cwt.). In 2008, milk prices remained high, but feed prices rose rapidly, creating concern for dairy farmers. The financial danger was a further escalation of feed prices or a price reversal in dairy product prices. Product prices have, in fact, dropped. Feed costs have declined some, but not enough to offset the drop in milk prices.

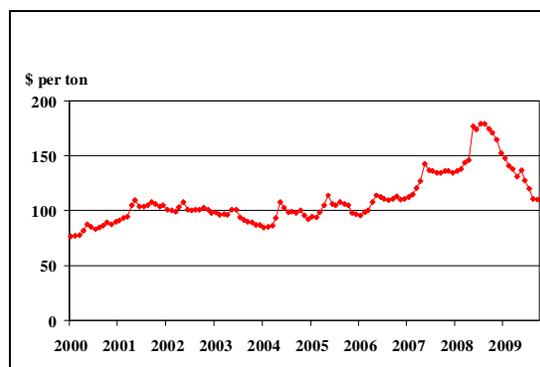
One simple measure of today’s price-cost squeeze affecting dairy farmers is the milk-feed price index, as reported by the U.S. Department of Agriculture (USDA). The ratio averaged 2.01 in 2008, the lowest since at least 1985 and down from 2.81 in 2007, a year with record-high milk prices. Thus far in 2009 (January-September), the ratio has averaged 1.56, down from the 10-year average of 2.90. A ratio near 3 or higher is considered positive for milk production.

Figure 1. Monthly All-Milk Farm Prices



Source: U.S. Department of Agriculture.

Figure 2. Monthly Alfalfa Prices



Source: U.S. Department of Agriculture.

The major factors leading to the current economic stress in the dairy industry are continued weak demand relative to milk supplies and relatively high feed costs. In 2009, USDA expects the all-

¹ Prices are from *Agricultural Prices*, U.S. Department of Agriculture (USDA), National Agricultural Statistics Service, September 29, 2009.

milk price to average between \$12.05 per cwt. and \$12.25 per cwt., down from \$18.29 per cwt. in 2008 and 17%-19% below the 10-year average of \$14.83.²

Milk Production Grows

Productivity growth is a hallmark of U.S. agriculture, and dairy is no exception. Over the years, improved dairy cattle genetics and better feed management practices have increased output per cow. Dairy farmers continued the advancement last year: USDA estimates milk per cow in 2009 at a record high of 20,493 pounds, up from 20,396 in 2008 (one gallon of milk equals about 8.6 pounds).

Normally, higher productivity is partially offset by a decline in cow numbers, resulting in more modest gains in total milk production. However, in 2008, dairy farmers increased herds in response to attractive returns, particularly in 2007. As a result, U.S. milk production rose 2.3% in 2008, compared with the increase in milk per cow of only 1.0%. Milk supplies expanded at about the same time that demand started to weaken.

In 2009, lower returns have encouraged farmers to cull dairy cows, with the national herd declining 123,000 head or 1.3%. Productivity gains, though, are expected to offset some of the reduction in cow numbers, leaving U.S. milk production down just 0.8%. In 2009, the decline in production has been less than the drop-off in demand, resulting in sharply lower prices than a year ago.

Demand Slows

Dairy exports account for a relatively small but important share of U.S. dairy product sales. On a fat basis, exports were estimated at 3% of total use in 2007 and 4% in 2008. (On a skim-solids basis, the export shares were 12% in 2007 and 15% in 2008.)³ Growth in U.S. dairy exports stemmed from lower product availability from New Zealand and Australia (and other countries) and the lower-valued dollar. U.S. cheese exports saw particularly strong gains.⁴

Export prospects have weakened in 2009, with USDA forecast exports dropping below 2007 levels. Among the factors USDA cites for the decline in export demand are the global recession, lower incomes, higher dairy production abroad, and a stronger dollar. The drop-off in export demand means that more product must be sold on the domestic market, which has driven down dairy product prices and farm milk prices.

Domestic demand has also reportedly slowed, given reduced restaurant sales and sales of premium food products, including some dairy items, as consumers reduce overall spending. However, increased purchases of food for home consumption are likely supporting the market to some degree in 2009.

² Current market situation and forecasts in this section are from *World Agricultural Supply and Demand Estimates*, USDA, World Agricultural Outlook Board, September 11, 2009; and *Livestock, Dairy, & Poultry Outlook*, USDA, Economic Research Service, September 17, 2009.

³ The milk equivalent of the dairy products can be calculated on the basis of fat content or skim-solids content.

⁴ USDA, Economic Research Service, *Livestock, Dairy, and Poultry Outlook* and *Feed Outlook*, various 2008 issues.

Feed Costs Climb

Feed costs rose sharply in mid-2008. Expanding corn demand for ethanol use, strong global demand for grain, and heightened investment in commodity markets collided with uncertain prospects for U.S. corn and soybean yields. In spring/summer 2008, massive flooding in the Midwest led to fears that the U.S. corn and soybean supplies would be sharply curtailed at a time when demand seemed limitless. In July 2008, the farm price of corn peaked at \$5.47 per bushel, up nearly \$2 per bushel from a year earlier. Alfalfa prices followed suit, with farm prices reaching \$180 per ton in August compared with \$135 a year earlier.⁵

The commodity price boom of 2008 began to collapse in September when financial and commodity markets faltered. Large amounts of investment money began to leave the market, and crop yield prospects for both corn and soybeans firmed up. Supply fears essentially evaporated.

As 2008 came to a close, prices for dairy feedstuffs had dropped substantially from highs earlier in the year but remained well above year-earlier levels. Corn prices in December averaged \$4.10 per bushel compared with \$3.77 in December 2007. The price of alfalfa was \$155 per ton in December 2008, compared with \$135 in December 2007. In contrast, soybean prices, which had seen a faster rise the year before, averaged \$9.24 per bushel, down from \$10.00 in December 2007.

Thus far in 2009, average prices for dairy feed have moderated from 2008 highs but remain well above 2007 levels. In recent months, USDA has revised its forecasts of 2009 corn and soybean prices downward based on prospects for larger crops this fall.

Outlook for 2009 and 2010

Given the downturn in dairy farm income, dairy economists expect producers in 2009 to send more cows to slaughter and adjust feed rations to save money, which together would result in a slight decline in total milk production in 2009.⁶ On the demand side, dairy exports in 2009 have declined as global economic weakness slows foreign demand. Based on USDA forecasts, the expected supply adjustments and higher support prices announced by USDA on July 31 will lift milk prices in the last quarter of 2009. Average farm-level milk prices are expected to rise from \$11.60 per cwt. in the April-June quarter to \$12.90 per cwt. in October-December 2009 (midpoint of the USDA forecast range). The October-December 2008 prices averaged nearly \$17 per cwt.

In 2010, USDA expects milk production to decline further as farmers cull more cows following low returns in 2009. Also, exports are expected to pick up slightly as the global economy improves, although USDA expects export prospects will be limited by higher domestic prices and larger exportable supplies in competitor countries. With less milk and somewhat higher demand, the all-milk price is forecast to increase from \$12.15 per cwt. in 2009 to \$15.05 per cwt in 2010.

⁵For more information on factors behind feed cost increases, see CRS Report RS22908, *Livestock Feed Costs: Concerns and Options*, by (name redacted).

⁶ In January, dairy producers increased herd culling in most regions of the country, according to *National Dairy Market News*, USDA, Agricultural Market Service, January 26-30, 2009. Also, prices for dairy heifers fell as demand declined for herd replacements.

Current Dairy Policies to Assist Producers

U.S. dairy policy has been developed over the last seven decades. The early policies addressed three main problems: (1) producers lacked bargaining power with milk buyers; (2) producers suffered from volatile or low prices; and (3) market participants encountered severe shortages/gluts resulting from marketing a highly perishable commodity (fluid milk). The policy response resulted in the development of two major government activities that still function today: federal milk marketing orders (FMMOs) and the Dairy Product Price Support Program (DPPSP). While both FMMOs and the DPPSP have their roots in the 1930s and 1940s, the programs have changed modestly over the years as the industry structure and markets changed.

Two other components of U.S. dairy policy are relatively new programs. First, the 1985 farm bill established the Dairy Export Incentive Program (DEIP) to counter foreign competitor subsidies. Second, the Milk Income Loss Contract (MILC) program was established in the 2002 farm bill as a government payment for dairy farmers in times of low milk prices. Like U.S. crop programs, the MILC program pays dairy producers when prices decline below a specified level.

The following sections describe each of these four components and how they relate to the current market situation.⁷ Lower milk and dairy product prices since late 2008 have generated new program activity. USDA began purchasing dairy products last fall under the DPPSP; MILC payments were triggered beginning in February.

Milk Income Loss Contract (MILC) Program

The Milk Income Loss Contract (MILC) program pays dairy farmers when farm milk prices fall below an established target price. Section 1506 of the 2008 farm bill (P.L. 110-246) extends authority for the MILC program until September 30, 2012. This program is similar to long-time subsidy programs for crops (e.g., wheat, corn, and soybeans) that pay farmers when farm prices drop below certain levels. USDA's Farm Service Agency implements the MILC program.

Under MILC, participating dairy farmers nationwide are eligible for a federal payment whenever the minimum monthly market price for farm milk used for fluid consumption (Class I; see discussion on "Milk Marketing Orders") in Boston falls below \$16.94 per cwt. Eligible farmers then receive a payment equal to 45% of the difference between the \$16.94 target price and the lower monthly market price. The payment quantity is limited to 2.985 million pounds of annual production (equivalent to about a 160-cow operation). Since the inception of the MILC program, large dairy farm operators have expressed concern that the payment limit has 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.

To address the issue of rising feed costs, the 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

⁷ Portions of this section are taken from CRS Report RL34036, *Dairy Policy and the 2008 Farm Bill*, by (name redacted) and (name redacted).

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 \$7.35.⁸

For the latter half of 2007 and all of 2008, farm milk prices remained well above the MILC trigger price, precluding the need for any MILC payments. However, milk prices have since declined below the trigger for MILC payments. The Class I Boston farm milk price for February 2009 (advance pricing) was \$13.97 per cwt. With the adjustment for feed costs raising the trigger to \$17.33 per cwt., MILC payments were activated for the first time in two years at a payment rate of \$1.51 per cwt. $((\$17.33 - \$13.97) \text{ times } 45\%)$.⁹ The payment rate rose to \$2.01 per cwt. in March. Given current prospects in the futures markets for milk, corn, and soybeans, payments are expected to continue during 2009, but at smaller rates.¹⁰ Individual producers must select which month to begin receiving payments, based on their projection of potential payment rates and the possibility of hitting the production payment limit. As of October 26, 2009, total MILC payments distributed to date were \$775 million (**Table 1**).

The timing of the payments has caused some concern for producers this spring. While milk price data become available during the payment month, data needed for the feed cost adjustor are not available until USDA publishes monthly average feed prices in *Agricultural Prices* at the end of the next month. Consequently, MILC payments for a particular month are not processed until two months later.

Dairy Product Price Support Program (DPPSP)

The Agricultural Act of 1949 first established a 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 multiyear omnibus farm acts and budget reconciliation acts. 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. Whenever market prices fall to product support levels, 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 for all dairy farmers. The effectiveness of the dairy price supports depends on removal of products from the market and placement into government storage.¹¹

⁸ In the final month of the program (September 2012), the payment percentage rate reverts to 34% so that the budget baseline for future years does not include the cost of the increase. Similarly, the eligible production limit reverts to its original level (2.4 million lbs.), and the threshold feed cost rises to \$9.50 per cwt.

⁹ Monthly payment rates published by USDA's Farm Service Agency are available at http://www.fsa.usda.gov/Internet/FSA_File/milc_rates.pdf.

¹⁰ Expected MILC payment rates based on futures prices are available from Cornell University at <http://www.cpdmp.cornell.edu/CPDMP/Pages/Home.html>.

¹¹ The program supports market prices by purchasing products, unlike USDA's marketing loan program for field crops. The marketing loan program minimizes government ownership of crops by encouraging farmers to sell their crop in the open market and receive a "loan deficiency payment" instead of placing the commodity under loan. If farmers do decide to place their crop under loan, the commodity serves as collateral, which may be forfeited to the government or (continued...)

Table I. Milk Income Loss Contract Program Payments
(April 1, 2009, through October 26, 2009)

State	Payments (\$ thousands)	State	Payments (\$ thousands)
Alabama	1,349	Nebraska	4,694
Alaska	47	Nevada	1,111
Arizona	4,729	New Hampshire	2,111
Arkansas	1,613	New Jersey	1,353
California	83,355	New Mexico	8,328
Colorado	5,034	New York	68,494
Connecticut	2,532	North Carolina	5,743
Delaware	667	North Dakota	2,403
Florida	4,604	Ohio	27,658
Georgia	6,732	Oklahoma	3,503
Hawaii	94	Oregon	8,121
Idaho	18,202	Pennsylvania	63,477
Illinois	13,184	Rhode Island	153
Indiana	11,959	South Carolina	2,063
Iowa	25,562	South Dakota	7,289
Kansas	5,886	Tennessee	7,822
Kentucky	9,116	Texas	20,025
Louisiana	2,475	Utah	6,685
Maine	4,293	Vermont	16,664
Maryland	6,606	Virginia	11,519
Massachusetts	2,156	Washington	14,902
Michigan	35,918	West Virginia	1,304
Minnesota	61,452	Wisconsin	161,907
Mississippi	2,052	Wyoming	353
Missouri	12,029	Puerto Rico	3,668
Montana	2,095	TOTAL	775,091

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

Notes: Payments in FY2009 began in April 2009, since farm milk prices were above the target price in previous months. For payments in previous fiscal years, see CRS Report RL34036, *Dairy Policy and the 2008 Farm Bill*, by (name redacted) and (name redacted).

(...continued)

repaid at the local market price if it is below the loan rate (i.e., the farmer sells the crop in the market, repays the loan, and receives a “marketing loan gain”).

The Dairy Product Price Support Program (DPPSP) as authorized by the 2008 farm bill 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 existing product purchase prices, so farm milk prices effectively continue to be supported at \$9.90.

In late 2008 and 2009, after several years of relative inactivity, the price support program resumed purchases when dairy product prices approached support levels. As of September 11, 2009, USDA estimated that it purchased 111 million pounds of nonfat dry milk under the program in 2008 and expects to purchase 379 million pounds in 2009, along with small amounts of butter and cheese (including amounts exported under the Dairy Export Incentive Program). Total expenditures on the DPPSP were \$223 million from October 1, 2008, through September 10, 2009.¹² With an expected rise in milk and product prices next year, USDA forecasts only a small amount of butter to be purchased in 2010.

Following heightened industry and congressional interest in taking action to boost milk prices for farmers, USDA announced on July 31, 2009, a temporary increase in price support for cheese and nonfat dry milk from August 2009 through October 2009. (See “Increase Price Support for Cheese and Nonfat Dry Milk” below for more information.) Subsequently, the Senate approved an amendment to the Senate-passed FY2010 agriculture appropriations bill to increase Farm Service Agency funding by \$350 million, ostensibly for an additional increase in dairy product price support levels.¹³ However, the conference agreement for the FY2010 Agriculture appropriations bill, which was enacted on October 21, 2009, provides for a different use of the funds (\$60 million to purchase dairy products and \$290 million in direct payments to farmers). See “Modifying Existing Programs to Enhance Dairy Farmer Income,” below, for more information.

Milk Marketing Orders

Federal milk marketing orders (FMMOs) mandate minimum prices that processors must pay producers for milk depending on its end use. This compares with the MILC program, which provides direct payments to producers, and the DPPSP, which buys surplus dairy products at specified minimum prices. The DPPSP serves as a price floor for products and undergirds FMMO minimum milk prices.

The farm price of approximately two-thirds of the nation’s fluid milk is regulated under FMMOs. Federal orders, which are administered by USDA’s Agricultural Marketing Service, 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.

¹² U.S. Department of Agriculture, *USDA Efforts Regarding Dairy*, briefing paper, September 11, 2009.

¹³ Senator Bernie Sanders, remarks in the Senate, *Congressional Record*, August 4, 2009, p. S8714.

FMMOs also address how market proceeds are distributed among producers delivering milk to federal marketing order areas. Producers 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 products) than for milk used in manufactured dairy products such as yogurt, ice cream, and sour cream (Class II), cheese (Class III), and butter and dry milk products (Class IV). 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.

Over the years, dairy farmers have supported minimum prices afforded by FMMOs because they help balance marketing power traditionally held by processors. In contrast, dairy processors generally oppose them. Mandated minimum prices, they say, do not allow for timely adjustments in a rapidly changing market and can leave product manufacturers in unprofitable situations. Also, they contend that the FMMO system distorts markets, saying fixed differentials contributed to high fluid milk prices last year.¹⁴

Dairy Export Incentive Program (DEIP)

First authorized in 1985, the Dairy Export Incentive Program (DEIP) provides cash bonus payments to U.S. dairy exporters. The program was initially intended to counter foreign—mostly European Union—dairy subsidies (while removing surplus dairy products from the market), but subsequent farm bill reauthorizations have added market development to the role of DEIP. Payments since the program’s inception have totaled \$1.1 billion. The program was active throughout the 1990s, peaking in 1993 with \$162 million in bonuses. DEIP funding is a mandatory account provided through the Commodity Credit Corporation (CCC) borrowing

¹⁴ International Dairy Foods Association, Dairy Forum, January 12, 2009.

authority from the U.S. Treasury, rather than through annual USDA appropriations bills.¹⁵ The program had not been used since FY2004 until USDA announced its reactivation on May 22, 2009. (See “Activate Dairy Export Incentive Program (DEIP),” below.)

U.S. dairy product exports made with DEIP bonuses are subject to annual limitations under the Uruguay Round Agreement of the World Trade Organization (WTO). The limits are 68,201 metric tons of skim milk powder, 21,097 tons of butterfat, 3,030 tons of various cheeses, and 34 tons of other dairy products (quantity limits are on a July-June year). Total expenditures under WTO commitments are now capped at \$117 million per year (value limits on a October-September year).

Requests for Action

The reversal of market fortunes for dairy farmers since 2008 has prompted calls from dairy producer groups to address the situation. The National Milk Producers Federation (NMPF), the largest trade association representing milk producer cooperatives, wrote to the Secretary of Agriculture on January 8, 2009, asking the Department to take several steps to assist dairy producers. Subsequently, letters to the Secretary were also sent by Members of Congress. On January 26, the International Dairy Foods Association, which represents dairy manufacturers and marketers, wrote to the Secretary, focusing only on ways to bolster demand for dairy products.¹⁶ The recommended industry actions deal also with revisions in the support program to increase dairy product purchases by the government, specifically asking USDA to be more flexible with the acceptable types and forms of eligible dairy products. Additional purchases are expected to spur domestic demand and slow the decline in prices. The request from NMPF also included reactivation of the Dairy Export Incentive Program to boost exports and remove excess inventory while helping exporters maintain business relationships developed in recent years.

In early May 2009, the National Milk Producers Federation reiterated its request that the U.S. government restart the Dairy Export Incentive Program to help remove excess dairy products from the market.¹⁷ Subsequently, NMPF asked USDA to increase the support prices of both cheese and nonfat dry milk.¹⁸

Another policy proposal is a dairy herd buyout to reduce the milk supply. A federal buyout has not been included in the NMPF requests, but it had been discussed in the agricultural media earlier in 2009.¹⁹ The industry currently operates a voluntary, producer-funded program to remove dairy cows from milk production. USDA operated a federal dairy herd buyout program in the mid-1980s.

¹⁵ CRS Report RL33553, *Agricultural Export and Food Aid Programs*, by (name redacted).

¹⁶ The National Milk Producers Federation wrote a second letter on January 29, 2009. It is available at http://www.nmpf.org/files/file/NMPF%20Ltr%20to%20Sec_%20Vilsack%20on%20Dairy%20Crisis%20012909.pdf. The January 26, 2009, letter from the International Dairy Foods Association is at http://www.idfa.org/news/stories/2009/02/vilsack_ltr_0202.pdf.

¹⁷ National Milk Producers Federation, “URGENT! Please Act Now—U.S. Dairy Export Incentive Program (DEIP),” press release, May 8, 2009, http://www.nmpf.org/files/file/DEIP%20Talking%20Points_2009_final.pdf.

¹⁸ National Milk Producers Federation, “NMPF Calls for Temporary Expansion of Dairy Price Support Program to Help Farmers,” press release, June 26, 2009, http://www.nmpf.org/latest_news/press_releases/dairy_price_support062609.

¹⁹ *Agweb.com*, January 21, 2009, and *TheCattleSite*, January 28, 2009.

In July 2009, the Subcommittee on Livestock, Dairy, and Poultry of the House Agriculture Committee held a series of hearings to review economic conditions facing the dairy industry. The subcommittee heard a range of opinions from the witnesses, with some asking for increased intervention in the form of higher support prices or supply management. Others argued that the industry would benefit if the government did nothing because inaction would more quickly bring supply in line with current demand.²⁰

USDA Actions To-Date

USDA has taken several actions in 2009 to support dairy farm income, including increasing dairy product price supports, transferring dairy products to domestic feeding programs, and activating the Dairy Export Incentive Program. USDA expects to spend about \$1 billion in fiscal 2009 on purchases of dairy products and payments to producers under the Milk Income Loss Contract (MILC) program.

Increase Price Support for Cheese and Nonfat Dry Milk

Following heightened industry and congressional interest in taking action to boost milk prices for farmers, USDA announced on July 31, 2009, a temporary increase in price support for cheese and nonfat dry milk from August 2009 through October 2009.²¹ This raises the government purchase price for nonfat dry milk from \$0.80 per pound to \$0.92 per pound, the price for cheddar blocks from \$1.13 per pound to \$1.31 per pound, and the price of cheddar barrels from \$1.10 per pound to \$1.28 per pound. Prior to the change, USDA expected that temporarily raising the price of these dairy products would increase the price that dairy farmers receive for their milk, boost U.S. dairy farmers' revenue by \$243 million, and result in the government purchase of an additional 150 million pounds of nonfat dry milk and an additional 75 million pounds of cheese. According to USDA, the purchases will be a no-net-cost transaction because the product will presumably be resold at higher prices when the dairy product market recovers next year. Following USDA's announcement, cheese prices rose to and above the new support levels,²² with the government purchasing less than 1 million pounds of nonfat dry milk (some of this product was sold as part of a packaging test). Separately, market observers have noted a modest strengthening in product markets overseas, with milk powder prices increasing in recent months following improved demand in Asia.²³

Transfer Product to Domestic Feeding Programs

On March 26, 2009, USDA announced that approximately 200 million pounds of nonfat dry milk (purchased under the Dairy Product Price Support Program) would be transferred from the Commodity Credit Corporation to USDA's Food and Nutrition Service for use in domestic

²⁰ Written statements from the hearings are available at <http://agriculture.house.gov/hearings/statements.html>.

²¹ U.S. Department of Agriculture, "Agriculture Secretary Vilsack Announces Immediate Relief For Struggling Dairy Producers," press release, July 31, 2009, http://www.usda.gov/wps/portal/tut/p/_s.7_0_A/7_0_1OB?contentidonly=true&contentid=2009/07/0355.xml.

²² Alan Levitt, *Dairy Dairy Report*, August 11, 2009, <http://www.dailydairyreport.com/>.

²³ Gavin Evans, "Dairy Prices May Make 'Slow, Gradual' Recovery, Fonterra Says," *Bloomberg*, September 23, 2009, http://www.bloomberg.com/apps/news?pid=email_en&sid=aRAFGHs40oNg.

feeding programs. Besides helping needy families by providing food through the National School Lunch program and others, the transfer is expected to increase dairy product consumption, thereby supporting the prices farmers receive for milk.²⁴

Activate Dairy Export Incentive Program (DEIP)

On May 22, 2009, USDA announced allocations under DEIP for the marketing year that ends June 30, 2009, as allowed under the rules of the World Trade Organization (WTO).²⁵ During the month of June, USDA accepted bids for nonfat dry milk, cheddar cheese, mozzarella cheese, butter, and anhydrous milk fat from exporters shipping to Africa, the Middle East, and Asia. On July 6, 2009, USDA announced initial DEIP allocations for the marketing year spanning July 1, 2009, through June 30, 2010. Subsidized export quantities are limited on a July-June marketing year basis. USDA had committed \$18 million in DEIP awards through September 10, 2009.

The use of export subsidies has the economic effect of moving more product into market channels, reducing inventories, and raising farm prices. However, economists say significant quantities would be necessary to appreciably move farm prices from current levels based on prevailing supply and demand. Free trade supporters caution that if price-enhancing DEIP export quantities are above the limits agreed to in the Uruguay Round Agreement, the U.S. government will need to break its World Trade Organization commitments; otherwise the action might result in little impact on farm milk prices.

Free trade supporters also say that policymakers need to weigh the merits of returning to an aggressive export subsidy stance, how export subsidies fit with current overall U.S. trade policy, and the potential reaction from major agricultural trading partners.

Producer groups favoring the reactivation of DEIP point to the European Union (EU), which has already taken action to address falling dairy prices in Europe. In January 2009, the EU announced it would restart its dairy export subsidy program for butter, cheese, and milk powder in an attempt to stabilize the domestic market.²⁶

For more information on DEIP, see CRS Report R40584, *Implications of Reactivating the Dairy Export Incentive Program (DEIP)*, by (name redacted) and (name redacted).

Potential Policy Responses

Most policy responses that are currently being discussed fall into three categories: (1) maintain the status quo and allow remaining programs to operate, (2) implement a new program such as a

²⁴ U.S. Department of Agriculture, "Agriculture Secretary Vilsack Announces Plan to Benefit Nutrition Programs and Dairy Farmers," press release, March 26, 2009, http://www.usda.gov/wps/portal/!ut/p/_s.7_0_A/7_0_1OB?contentidonly=true&contentid=2009/03/0071.xml.

²⁵ U.S. Department of Agriculture, "USDA Announces 2008-09 Allocations for Dairy Export Incentive Program," press release, May 22, 2009, http://www.usda.gov/wps/portal/!ut/p/_s.7_0_A/7_0_1OB?contentidonly=true&contentid=2009/05/0178.xml.

²⁶ European Commission, "Dairy Market: Commission Proposes Additional Measures to Help Dairy Sector," press release, January 15, 2009, <http://europa.eu/rapid/pressReleasesAction.do?reference=IP/09/57&format=HTML&aged=0&language=EN&guiLanguage=en>.

dairy buyout, and (3) modify existing programs to enhance dairy farmer income. Each is discussed in sections below.

A change in federal milk marketing orders could also be used for boosting dairy farm returns. The Federal Milk Marketing Improvement Act of 2009 (S. 1645; first introduced as S. 889) is expected to “help farmers get a fair price for their milk” and provide relief and assistance to dairy farmers by using the cost of milk production as the basis for pricing milk.²⁷ While the bill could raise farm milk prices, some are concerned that it could also reduce the competitiveness of the U.S. dairy industry because, they argue, a pricing system based on cost of production potentially rewards inefficiency. Also, some are concerned that provisions in the bill for USDA to influence supply may not be sufficient to bring supply and demand into balance.

Increasing import barriers is another approach for addressing the issue of low milk prices. The Milk Import Tariff Equity Act was introduced in the Senate (S. 1542) on July 30, 2009, and in the House (H.R. 3674) on September 29, 2009, to impose tariff-rate quotas on imports of casein (the main protein found in milk) and milk protein concentrates.²⁸ Similar bills have been introduced in virtually every Congress over the last decade, but no action has occurred. For more information, see CRS Report R40839, *Proposed Import Restrictions on Milk Protein Concentrates (MPCs)*.

The current and prospective price environment complicates the policy decision. Given reduced returns, producers are culling herds and reducing milk production, which is expected to lift farm prices. However, the full effect of the production decisions is expected to take several more months.²⁹

Status Quo

One option for policymakers is to do nothing and allow current programs to operate as intended. U.S. dairy programs, particularly the DPPSP and MILC, are now operative. USDA has been purchasing dairy products in 2009 under the DPPSP. These actions take excessive inventory off the market and support overall milk prices.

Similarly, the MILC program is expected to continue making payments to dairy farmers in 2009. To the extent that feed prices remain above the threshold level, the feed cost adjustor plays a role in compensating dairy farmers to offset the high cost of feed.

Supporters of the status quo argue that current dairy programs already encourage additional milk production when the market is not calling for it. The International Dairy Foods Association (IDFA), representing dairy manufacturers, contends that the MILC program, the dairy product

²⁷ Office of Senator Arlen Specter, “Specter, Casey Work to Help Dairy Farmers,” press release, April 24, 2009, http://specter.senate.gov/public/index.cfm?FuseAction=NewsRoom.NewsReleases&ContentRecord_id=D92E3B27-A176-FOA0-E68C-40B249E3492E.

²⁸ Tariff-rate quotas impose low import duties on quantities inside a quota, while quantities above the quota are charged higher duty rates. Milk protein concentrate (MPC) 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 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.

²⁹ Further complicating the supply adjustment was unseasonably cool weather in several dairy-producing areas in late spring, which reportedly resulted in higher-than-expected milk production.

price support program, and recent USDA decisions on FMMOs contribute to excess milk supplies. Similarly, some farmers do not favor raising support prices because “... it has the strong potential to send the wrong signal to the market to increase or at least maintain, rather than to decrease, production.”³⁰ As a result, modifications to enhance producer incomes could exacerbate the milk supply and price situation. At any rate, any proposals that involve new budgetary outlays could be challenged as adding to an already large federal deficit and/or burdening consumers with higher costs.

Proponents of additional action point out that many producers are facing significant income loss and that without additional assistance, they may not survive financially. Also, some producers argue that the level of support—no longer specified for milk directly, but effectively providing support at roughly \$9.90 per cwt—is too low given current feed prices.

Dairy Herd Buyout Program

In 1986 and 1987, the Dairy Termination Program, authorized under the Food and Security Act of 1985 (P.L. 99-198, the 1985 farm bill) was designed to reduce government costs associated with federal purchases of surplus dairy products. The program paid participating farmers to remove more than 1 million dairy cows from milk production, or about 9% of the U.S. dairy herd in 1985. Participating farmers were barred from the dairy industry for five years. The program temporarily reduced the nation’s milk production capacity and was designed to ease farmers’ transition to a lower price support level that was also included in the 1985 farm bill.³¹

One concern with pursuing another buyout is raised by the beef industry. Beef producer groups note that dairy cow slaughter under the 1980s program added beef to total meat supplies, which reduced beef and cattle prices. Under the Dairy Termination Program, USDA purchased beef for other programs as a way to lessen the price impact on the beef and cattle markets.³²

The National Milk Producers Federation (NMPF) currently operates its own, producer-funded dairy buyout program called Cooperatives Working Together (CWT). It has purchased and removed from dairy production 276,000 cows representing more than 5 billion pounds of annual milk production during its first six herd retirement rounds, which began in 2003.³³ In early February, the NMPF said it was not pursuing a new federal program.

On May 1, 2009, the CWT closed its seventh round of bidding for dairy cow purchases. Dairy cow culling reportedly slowed in March and April as farmers who had applied for the program

³⁰ U.S. Congress, House Committee on Agriculture, Subcommittee on Livestock, Dairy, and Poultry, *To Review Economic Conditions Facing The Dairy Industry*, Statement by Craig Lang, President of Iowa Farm Bureau, 111th Cong., 1st sess., July 28, 2009, <http://agriculture.house.gov/testimony/111/h072809/Lang.pdf>. Note that his testimony also supported the removal of the MILC production payment limitation.

³¹ General Accounting Office (now Government Accountability Office), *Dairy Programs: Effects of the Dairy Termination Program and Support Price Reductions*, June 1993.

³² USDA, Economic Research Service, “The Dairy Buyout: A New Approach to an Old Problem,” *Farmline*, April 1986.

³³ Under CWT’s program, the producer is paid 90% of the bid total when CWT verifies that the farm has sent all the milk cows to slaughter. The final 10% (plus interest) is paid when CWT verifies that neither the producer nor the dairy facility has commercially produced milk during the 12 months following the CWT farm audit. Statistics are available at <http://www.cwt.coop>.

awaited the results.³⁴ CWT announced in mid-May that it had accepted bids representing nearly 101,000 cows and almost 2 billion pounds of milk production capacity, CWT's largest single herd retirement program to date.³⁵ Herd culling occurred over the summer months. On July 10, 2009, CWT announced its eighth round, which was completed September 24, 2009. Compared with previous rounds, the bid period was shortened to two weeks in order to have a more immediate impact. In this round, CWT accepted bids on 74,114 cows, representing 1.5 billion pounds of milk. Also, nearly 3,000 bred heifers were sent to processing plants.³⁶ Most recently, on October 1, 2009, CWT announced yet another round, with bids due by October 15.

A herd buyout-related bill was introduced in Congress on July 23, 2009. H.R. 3322 would direct USDA to use Section 32 funds to enter into a contract with a producer association or other third party to encourage dairy producers to remove dairy cows from production. It would also temporarily increase MILC payments (see next section).

Modifying Existing Programs to Enhance Dairy Farmer Income

Another option being offered to address the current market situation is to modify existing programs. The National Farmers Organization (NFO) and other farm groups have proposed adding funds to increase the amount of Milk Income Loss Contract (MILC) payments, which resumed in February 2009. The groups contend that adding payments to the existing income support program provides a necessary addition to dairy farmer income. Several bills have been introduced in Congress to increase MILC payments.³⁷ However, opponents of this option argue that additional payments could slow the supply adjustment process needed to bring the dairy market back into balance. Congressional leadership has reportedly been reluctant to act on the proposal because the move would be considered as re-opening the 2008 farm bill, which would likely result in a multitude of requests from other groups seeking changes.

Earlier in 2009, the National Milk Producers Federation proposed several administrative changes to the price support program, such as loosening packaging requirements and expanding the list of eligible products. Such changes would likely remove additional products from the market and provide some additional support to prices. Similarly, the International Dairy Foods Association (IDFA) proposes to boost demand by exchanging government-owned bulk dairy inventory for consumer-ready dairy products and using existing authorities to purchase and donate additional dairy products like yogurt. A regulation addressing some of these issues is currently in review at USDA.

In October, low financial returns for dairy farmers prompted Congress to make additional financial assistance available by including funds for dairy farmers in the FY2010 Agriculture appropriations bill (P.L. 111-80), which was enacted on October 21, 2009.

³⁴ University of Idaho, "PNW Dairy Monitor," press release, May 18, 2009, http://www.ag.uidaho.edu/aers/PDF/PNW/2009/PNW_MON_MAY09.pdf.

³⁵ Cooperatives Working Together, "CWT To Remove Over 100,000 Cows, 2 Billion Pounds of Milk in Largest-Ever Herd Retirement," press release, May 13, 2009, http://www.cwt.coop/about/news_releases/news_release_051309.pdf.

³⁶ Cooperatives Working Together, "CWT Completes Eighth Herd Retirement Round," press release, September 24, 2009, http://www.cwt.coop/sites/default/files/news_releases/Herd%20retirement%20details%2020092409.pdf.

³⁷ Several bills would increase the MILC payment factor from 45% to 90% between March 1, 2009, and November 30, 2009, including S. 1330 (introduced on June 23, 2009), S. 1398 (July 6, 2009), and H.R. 3322 (July 23, 2009). Other bills (S. 1331 and H.R. 3166) would adjust the payment rate for inflation.

The enacted appropriation (in the General Provisions, Section 748) provides a total of \$350 million, divided between \$290 million for supplemental income payments to dairy farmers and \$60 million for the purchase of cheese and other dairy products to be distributed through food banks and similar locations. Provisions for expedited rulemaking are expected to allow USDA to make the additional payments in a timely manner.

The bill does not specify how the Secretary should allocate the funding for direct payments among producers. This issue is a source of contention because the eventual distribution method used by the Secretary will determine which size of farm will receive the most benefits.³⁸ Under the Milk Income Loss Contract (MILC) program, for comparison, the payment quantity is limited to 2.985 million pounds of annual production (equivalent to about a 160-cow operation), as specified in the 2008 farm bill.

The idea for an additional dairy appropriation originated in the Senate-passed bill, which included an amendment for an additional \$350 million in FSA salaries and expenses, ostensibly for dairy disaster assistance through an increase in dairy product price supports.³⁹ Amendment proponents in Congress expected that the additional funding, if used for the price support program, would raise minimum purchase prices another \$0.05 per pound for nonfat dry milk and \$0.09 per pound for cheese from levels USDA announced on July 31, 2009.⁴⁰ The House-passed appropriations bill did not have a similar provision.

The National Milk Producer Federation (NMPF), representing dairy farmers, favors direct purchases, while the National Farmers Union supports higher purchase prices. NMPF contends removing surplus products would raise overall price levels and provide benefits through higher market prices that would be nearly four times greater than the value of benefits derived from either higher purchase prices under the DPPSP or additional direct farmer payments.⁴¹ In contrast, the International Dairy Foods Association (IDFA) favors other options to minimize market impacts, including additional MILC payments and government purchases of a wide variety of products rather than a large-scale purchase of a single product such as cheese. IDFA also argues against higher purchase prices that, they say, would increase costs for food processors and encourage additional milk production, exacerbating the milk surplus problem.

³⁸ Office of Senator Barbara Boxer, "Boxer Requests Urgent Meeting with Agriculture Secretary to Discuss Fair Distribution of Emergency Dairy Funding," press release, October 1, 2009, <http://boxer.senate.gov/news/releases/record.cfm?id=318568>.

³⁹ The amendment added funding for Farm Service Agency salaries and expenses without specifying that it should be used for price support. However, on the Senate floor, Senator Bernie Sanders stated that the funding would be for higher price supports. See *Congressional Record*, August 4, 2009, p. S8714. The amendment was controversial since it was designated emergency funding and was not offset elsewhere in the bill. The Sanders amendment (S.Amdt. 2276) was adopted by voice vote, after a procedural vote of 60-37 to waive budget rules to allow the bill to exceed its 302(b) appropriations subcommittee allocation. The House-passed bill did not have a similar provision. The funding in the conference agreement does not have the emergency designation with regard to funding ceilings.

⁴⁰ Office of Senator Bernie Sanders, "Senate Approves Help for Dairy Farmers," press release, August 4, 2009, <http://sanders.senate.gov/newsroom/news/?id=a8567c42-8810-4e1d-a752-5776662bc0ac>.

⁴¹ Letter from Jerry Kozak, President and CEO, National Milk Producers Federation, to Senator Herb Kohl, September 9, 2009, <http://www.nmpf.org/files/file/AgApprops%20letter%20on%20Sen%20Sanders%20350M%20dairy%20amendment.pdf>.

Current Regulatory Issues

Recent USDA regulatory actions have included a dairy import assessment as part of the 2008 farm bill implementation, as well as proposed changes to federal milk marketing orders.

Dairy Import Assessment

On May 19, 2009, USDA published a proposed rule in the *Federal Register* to establish a dairy import assessment program as required by the 2002 and 2008 farm bills. U.S. dairy producers in the 48 contiguous states currently pay a 15-cent per cwt. assessment on all milk produced to fund a national dairy producer program for generic dairy product promotion, research, and nutrition education. Authorization for the program stems from the Dairy Producer Stabilization Act of 1983 (7 U.S.C. 4501-4514). The 2002 farm bill (Section 1505) amended the act requiring that the assessment also be collected on all imported dairy products. After consulting with the Office of U.S. Trade Representative (USTR), the Secretary of Agriculture determined that a mandatory dairy import assessment was 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.

To remedy the situation, Section 1507 of the 2008 farm bill extends the domestic assessment to Alaska, Hawaii, and Puerto Rico. The statutory change is designed to make the definition of the United States consistent with the definition used by the USTR and U.S. trading partners, thus allowing the assessment on imported products. The enacted 2008 farm bill also sets the assessment on imports at 7.5 cents per cwt.

The import assessment is supported by most dairy producer groups because importers “benefit from domestic dairy promotion efforts without contributing to programs aimed at growing the U.S. market.”⁴² 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. The argument is that because some imported products are subject to quantity limits under tariff rate quotas, importers will not benefit from the assessment in terms of building additional demand for their product.

Producer-Handler Exemptions in Federal Milk Marketing Orders

In May 2009, USDA held a public hearing on proposals to amend federal milk marketing orders (FMMOs) regarding producer-handler provisions. 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.⁴³

⁴² National Milk Producers Federation, “News for Dairy Co-Ops,” press release, May 4, 2009, http://www.nmpf.org/latest_news/news_dairy_coops/may_4_09articles.

⁴³ For more information, see USDA, Agricultural Marketing Service, <http://www.ams.usda.gov/AMSv1.0/ams.fetchTemplateData.do?template=TemplateD&navID=IndustryMarketingandPromotion&leftNav=IndustryMarketingandPromotion&page=ProducerHandlers&description=Producer-Handlers&acct=dmktord>.

Currently, dairy farmers who qualify as producer-handlers under federal milk marketing orders are exempt, as handlers, from the pricing and pooling provisions of the orders. The provisions require handlers to pay minimum prices to dairy farmers for milk depending on its use (e.g., fluid milk, cheese). The pooling process redistributes revenue among producers from across a marketing area (10 regions in total) so that all producers receive the same “blend” price. Thus, as handlers, the producer-handlers can produce and sell their milk without being required to participate in the pool, and therefore not be subject to paying minimum prices as other handlers must do. As a result, producer-handlers may have a cost advantage over other handlers. This possibility helped motivate proposals to eliminate the producer-handler exemption.

The proposed changes would eliminate or modify who is exempt from federal marketing orders. Some of the proposals allow for continued exemptions for producer-handlers based on the size of the operation, ranging from milk production of 450,000 pounds of milk per month (equivalent to about a 275-cow operation) to 3 million pounds per month (about 1,750 cows). Nationwide, about 15 producer-handlers fall into that range of production. Three other firms are larger yet.

On October 21, 2009, USDA issued a recommended decision that would limit exemption from pooling and pricing provisions of federal orders to those producer-handlers with total route disposition of fluid milk products of 3 million pounds or less per month.⁴⁴ After a 60-day comment period, USDA will issue a final decision.⁴⁵ A referendum is then conducted among individual producers (or as represented by cooperatives) and, if approved by two-thirds of producers, the amendment to the order is made effective by final rule in the *Federal Register*. A negative vote on an amended order would eliminate the order.

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⁴⁴ USDA Agricultural Marketing Service, “USDA Issues Recommended Decision on Proposed Amendments to all Federal Milk Orders,” press release, October 21, 2009, <http://www.ams.usda.gov/AMSV1.0/ams.fetchTemplateData.do?template=TemplateO&navID=CommodityAreas&leftNav=CommodityAreas&page=FMMOrder21>.

⁴⁵ Expedited procedures for altering FMMOs were established in the 2008 farm bill (P.L. 110-246).

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