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DAIRY TITLE

THE FEDERAL AGRICULTURE IMPROVEMENT AND REFORM ACT OF 1996

By

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THE FEDERAL AGRICULTURE IMPROVEMENT AND REFORM ACT OF 1996

Ed Jesse and Bob Cropp[1]

President Clinton signed the Federal Agriculture Improvement and Reform Act of 1996 (FAIR Act) into law on April 4, 1996. The new law makes major changes in some commodity programs, especially feed grains and wheat. After more than 35 years of conforming to acreage restrictions, grain farmers will have nearly unlimited discretion in selecting crops to grow and still be eligible to receive government "transition" payments. Changes in other commodity programs, including dairy, were substantially less dramatic.

In this paper, we discuss the dairy title of the FAIR Act. We begin by tracing the evolution of the dairy title. We then present a brief sketch of the major provisions, followed by a more analytical discussion of their rationale and their likely effect on the Wisconsin dairy industry.

How We Got There

The writing of what was to be the 1995 Farm Bill (passed and signed into law well into 1996) was a long, tortuous, and contentious process. Many of the delays, false starts, and rewrites were attributable to regional factionalism in dairy. Perhaps not unexpectedly, the dairy title of the bill is more a product of power politics than a reasoned debate about how federal regulations can best help the dairy industry position itself to be competitive in the 21st century.

Wisconsin Congressman Steve Gunderson, Chairman of the House Livestock, Dairy and Poultry Subcommittee, led the process of writing the dairy title from the beginning. He first

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outlined the parameters for new dairy legislation in a November 1994 speech before the National Milk Producers Federation (NMPF) annual meeting. Gunderson indicated that in the upcoming farm bill, the dairy industry would either need to support comprehensive dairy program reforms in line with industry needs of the 21st century or he would move to deregulate dairy industry programs. In other words, Gunderson told the industry that status quo was not an option for dairy.

In April 1995, the Livestock, Dairy and Poultry Subcommittee held a series of field hearings throughout the country to receive suggestions from dairy farmers and other interested parties about what they wanted in the way of legislation. These field hearings were followed in May by two hearings in Washington, DC, to receive testimony from USDA officials, dairy trade associations, academicians, and others about more technical aspects of dairy price supports and federal milk marketing orders.

The result of this extensive fact-finding process was a House bill authored by Steve Gunderson entitled *The 21st Century Dairy Transition and Reform Act.* Later termed more simply, *Gunderson I*, the comprehensive bill proposed a single national milk marketing order with common minimum manufacturing milk prices, five pricing zones, and national pooling of $1.00 of Class I revenues. Within the five pricing zones, Class I prices were tied to Class I utilization, not distance from Eau Claire, Wisconsin. The proposal would have terminated butter and nonfat dry milk support purchases upon passage and ended supports for cheese in 2000. Dairy assessments were ended, and a national Class IV pool was established that would have pooled the entire difference between a target price for milk used for butter and powder and the market price.

Ironic in light of future developments, Gunderson I would have benefitted practically every dairy region. The proposal contained numerous compromises designed to garner broad support. In fact, many Midwesterners grumbled about the proposal because of the Class IV pooling arrangement, which would have hurt regions prominent in cheese, and Class I price increases in some areas.

Gunderson I was developed with much give and take in order to address issues of concern for all regions. But it became clear in the final weeks before the scheduled Committee markup for the bill that regional interests were mounting their opposition to it. At that point, Guderson, as he promised at the start, warned the dairy industry that he would propose deregulation as the only alternative to Gunderson I.

For a short time, it appeared that Gunderson I had a chance of adoption. Leadership of NMPF, while not happy with parts of the proposal, initially accepted national pooling of Class I receipts, the most controversial provision. The attempt at agreement was short-lived. NMPF soon abandoned attempts at compromise and, instead, embraced the *Springfield Plan*, a proposal of Mid-America Dairymen, Inc., headquartered in Springfield, Missouri.

The Springfield Plan adopted the dairy price support changes in Gunderson I, including Class IV pooling and termination of butter-powder supports. But it rejected changes in federal order pricing. Worse, from the perspective of Chairman Gunderson's constituents, it would have elevated Class I differentials in any market with more than 40 percent Class I utilization. Adoption of the Springfield Plan was little more than a glove in the face of Congressman Gunderson. It said, in effect, "We believe that you are bluffing on your threat to deregulate, and even if you're not, we believe that we have the political power to prevent a deregulation bill."

Congressman Gunderson was not bluffing. Upon rejection of Gunderson I by NMPF, he abandoned the proposal in favor of a deregulation dairy title to the House Livestock, Dairy, and Poultry subcommittee. The new proposal, popularly termed *Gunderson II*, would have terminated the dairy price support program upon passage and ended federal order pricing on July 1, 1996. It would have retained the plant audit and verification provisions of federal orders. It would also have instituted recourse loans to processors and made declining transition payments to dairy farmers over the seven year life of the bill.

The House subcommittee adopted Gunderson II. It became the *Freedom to Milk* dairy title of the overall House Committee on Agriculture "Freedom to Farm" farm bill proposal.

But the full House Agriculture Committee was not prepared to adopt any proposal. During Committee deliberations on Freedom to Farm, the Springfield Plan was offered as an amendment. It failed by a large margin. Then, *Springfield Lite* (the Springfield Plan without elevated Class I differentials) was offered and also rejected. Freedom to Farm remained intact. Then, in a late-night fit of renunciation spurred by dairy as well as cotton, peanut, and sugar interests, the Committee rejected Freedom to Farm in its totality and adjourned without a report.

Without a Committee proposal, House leadership "encouraged" the House Budget Committee to adopt Freedom to Farm as initially proposed as part of the omnibus House of Representatives budget package.[2] The House Rules Committee decided not to allow amendments to the package when it was considered by the full House. Thus, Freedom to Farm became the de facto House agriculture proposal despite the fact that it was never approved by the House Agriculture Committee.

Subsequently, the House of Representatives voted to approve the budget bill, but only after House leadership promised to placate key New York Congressmen who had dairy constituents in their home districts in the conference committee that would iron out differences between the House and Senate budget titles. Freedom to Farm, which included deregulation aka Gunderson II aka Freedom to Milk, remained alive.

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[2] The farm bill was initially part of the omnibus budget reconciliation package in both the House and the Senate. This was a major departure from past farm bill procedures Different rules and procedures affected the bill's movement through the legislative process.

Meanwhile, back in the Senate, the Senate Agricultural Committee adopted a modification of Springfield Lite as its dairy proposal. The Senate proposal involved no changes in federal orders. It eliminated support prices for butter and nonfat dry milk and reduced the support price for cheese.

At this juncture, supporters of status quo dairy policy began an intense lobbying campaign to promote the Senate dairy proposal. Headlines in widely-distributed fliers from NMPF and Mid-Am urged farmers to contact their elected representatives to "just say no" to freedom to milk. Within and outside the editorial columns of dairy magazines, freedom to milk was renamed freedom to foreclose. Deregulation of the dairy industry was ominously forecast to reduce milk prices by more than 10 percent, which would lead to the demise of countless thousands of dairy farmers.

Senate leader Dole and Agriculture Committee Lugar were both involved in the presidential primary race in New Hampshire. They were interested in hearing from their New England colleagues in the Senate. They quickly conceded to allowing amendments to the dairy title when the budget bill reached the Senate floor. Vermont Senator Jeffords quickly exploited this concession, orchestrating the offering of the Northeast Compact as an amendment. The amendment passed, mainly because few Senators knew what it was or what it did. Thus, a bad Senate dairy title was made even worse.

Action on the dairy title moved to the House-Senate Conference Committee, which was obligated to reconcile the House deregulation proposal with the Senate super-regulation proposal. The reconciliation of irreconcilable differences could have proven to be an interesting process. But the process was cut short when Congressman Solomon (R-NY) threatened to get the entire New York State Congressional delegation to vote against the budget package if federal orders were altered in the dairy title. Faced with the prospect of having dairy derail the whole budget package, House Leader Newt Gingrich agreed to not include a dairy title in the bill.

A short time later, the exclusion was made moot when President Clinton vetoed the budget bill. It was referred back to the House and Senate for modifications. Agriculture provisions would subsequently be developed separate from the budget package. End of round I.

Round II began at NMPF's annual convention in Nashville in late November. The convention started as an acrimonious event, with hallway finger-pointing and less subtle accusations and counter-accusations among members regarding destruction of dairy programs in the recently-ended legislative process. Ultimately, regional differences were temporarily put aside and an agreement struck on a new dairy proposal. The *Tennessee Compromise* was a true compromise, containing some features that each region supported and some that each opposed.

The Tennessee compromise contained much of what was in earlier proposals that was not regionally contentious. Budget assessments were repealed. Support purchases for butter and powder were terminated. Cheese continued to be supported at a milk equivalent price of $10.35

per hundredweight. The three primary compromise provisions, all to be in effect for 2 years only, were:

(1) National pooling of $.80 per hundredweight of Class I receipts;

(2) National pooling of 50 percent of the difference between the support price applying to milk for cheese ($10.35) and the average market price for milk used to produce nonfat dry milk (Class IV pooling); and

(3) A Class I price floor equal to the federal order price in effect in January 1996.

In addition, the compromise required USDA to consolidate milk marketing orders to achieve no more than 13 or fewer than 8 orders. It also provided for the creation of stand-by pools to facilitate milk movements to deficit fluid markets.

With prospects for moving a dairy title being very limited at the time, Congressman Gunderson sought to build on the Tennessee Compromise as a means of generating enough political support to move the stalled title. California was one key political ally missing in the Tennessee Compromise. So discussions began with California dairy interests to obtain their support for a new dairy package. California wanted to share in the fluid milk pool, application of California nonfat solids standards for fluid milk nationally, complete Class IV pooling of the difference between the support price for cheese and the nonfat dry milk price, permanent Class IV pooling, and no substantive change in the make allowances used in California.

In subsequent markup of the bill, California got some of what it wanted. In particular, California producers were made eligible for the Class I national pool and California fluid milk standards were made national in scope. Make allowances applicable to government purchases of cheese and the Class IV pool were adjusted to compromise between the values used in California and those used in the rest of the U.S.

Other changes made during markup speeded the process of order consolidation. USDA was granted special rule-making authority with expedited procedures. And a "hammer" was created to force USDA to act quickly: If the new consolidated orders were not in place within two years, legislative authority for price supports, federal milk orders, export subsidies, and dairy promotion programs would be repealed.

The new dairy title was approved by the House Livestock, Dairy and Poultry Subcommittee and the House Agriculture Committee in early February. It came under immediate attack by the International Dairy Federation (IDFA), representing dairy processors. IDFA had two bones of contention; the higher nonfat solids standards for fluid milk and the high fluid milk price floor. According to IDFA, these provisions would have sharply elevated fluid milk costs and substantially reduced demand. IDFA orchestrated a surprisingly successful public relations campaign. National prime-time network newscasters told of secret deals made in Congress that would require "additives" in milk and line dairy farmers' pocketbooks.

The negative national publicity was probably enough to spell doom for the modified Tennessee Compromise. But it was the federal order "hammer" that really did it in. Congressman Solomon was the declared champion of the current system of federal orders, the hero of Northeastern dairy interests who opposed even minute changes in federal order pricing rules. He was not prepared to stand for a quick USDA decision on merging federal orders. He teamed with Congressman Dooley (D-CA) to introduce an amendment on the House floor to replace the Tennessee Compromise with the *Solomon-Dooley Proposal.* This move by Solomon and Dooley fit nicely with Senate Agricultural Committee preferences for dairy programs, especially Committee Chairman, Richard Lugar, whose staff played a significant role in drafting and supporting the Solomon-Dooley amendment in the House.

Compared to the Tennessee Compromise, the Solomon-Dooley proposal was straightforward: Eliminate the budget assessment. Maintain the support program for butter-powder and cheese for five years with the support level decreased from $10.15 to $9.75 over that period. Ask USDA to consolidate orders to no more than 14 by the end of the year 2000. If that didn't happened, USDA could not use public funds to administer orders. Require the Secretary to establish multiple basing points for pricing milk, with the clear intent to allow regional pricing for both fluid and manufacturing milk. Retain the Dairy Export Incentive Program (DEIP). Exempt California from national rules pertaining to nonfat solids standards in fluid milk. Repeal Section 102 (obligating California to conform with national make allowances for products purchased under the Dairy Price Support Program). The amendment passed by a large margin. Most of the opposing votes came from Midwestern Members of Congress.

Meanwhile, the Senate decided not to forward a dairy title. The Conference Committee was again faced with an daunting task: Compromising no proposal (Senate) with one that was the response to negative national press and offered little to anyone in the way of meaningful reform.

Some small changes in the Solomon-Dooley proposal were made in conference. The five-year order consolidation schedule was shortened. Clauses were added authorizing (but not requiring) USDA to consider multiple basing points and fluid milk utilization rates in setting Class I pricing formulas in consolidated orders and uniform multiple component pricing in setting prices for manufacturing milk.

The Conference Committee also made one large change: It authorized the Northeast Compact, a fluid milk pricing arrangement independent of federal orders. Midwest legislators had successfully fought the compact for two years. By introducing the compact through the back door of the conference committee, supporters were finally able to avoid meaningful opposition.

The Dairy Title in Brief

Dairy Price Support Program:

- Ends producer budget assessments (CCC assessments, or Milk Tax).

- Continues purchase program for butter, nonfat dry milk, and cheddar cheese at declining purchase prices. Support program terminated at the end of 1999 and replaced with a recourse loan program in 2000.

- Repeals Section 102 of the 1990 farm act and substitutes a ceiling on state make allowances.

Federal Milk Marketing Orders:

- Requires USDA to consolidate to no more than 14 and no less than 10 orders within three years.

- Authorizes USDA to consider using multiple basing points and fluid milk utilization rates in setting Class I prices in the consolidated orders.

- Authorizes USDA to consider using uniform multiple component pricing in designing a new Basic Formula Price.

Dairy Export Programs:

- Extends and fully funds Dairy Export Incentive Program (DEIP) through 2002.

- Authorizes USDA to assist in forming export trading companies.

- Requires USDA to study impact of expanded cheese import access.

- Authorizes the National Dairy Board to use funds for export market development.

Other Major Provisions:

- Exempts California from federal standards of identity for fluid milk.

- Authorizes the Northeast Interstate Dairy Compact for a limited time.

Milk Price Support Program and Related Dairy Export Provisions

Price Supports and Producer Assessments. The 1996 Act maintains the support program for four years, 1996-1999. But, the support level, initially at $10.35 per hundredweight for 1996, declines $.15 each year. The support price will be $10.20 in 1997, $10.05 in 1998, and $9.90 in 1999, the last year of a support price.

Because the support price declines each year and ends in four years, budget savings from this action were deemed sufficient to end the $.10 per hundredweight producer assessments initiated January 1,1996. The $.10 assessment ends effective the first of the month following the month the President signs the bill into law. Since the President signed the bill on April 4, the assessments will end on April 30,1996..

Most producers saw little benefit from the support program and were not pleased with paying assessments. If the dairy price support program would have continued at the $10.10 per hundredweight or higher, most likely producer assessments would have been increased to meet budget limitations at some point during the duration of the 1996 Act, 1996-2002. So there was a strong feeling among producers that they would be better off with no support program, if it meant eliminating the assessments. Yet, many dairy processors, particularly those on the west coast that are major manufacturers of butter and nonfat dry milk, and some producers believed that there were significant benefits from the support program and argued for its continuation. They were of the opinion that butter and nonfat dry milk prices would likely be lower and more volatile at times without the support program. And lower butter and nonfat dry milk prices would spell lower producer milk prices. A compromise was reached in the 1996 Act by phasing down and not eliminating immediately the support program in order to give the industry time to adjust to there being no support program.

But the fear of substantially lower producer prices without a support program is unfounded. From 1990 through 1995, the support price was set at $10.10 per hundredweight for milk of average test, 3.67 percent milk fat. This was below the full cost of production for most all dairy producers and below the cash cost of production for many. As a result, the price paid to producers for manufacturing grade milk was above the support price each month during this entire five year period. The only surplus dairy products purchased under the support program that were of any significant quantity were mostly butter, and at times, limited quantities of nonfat dry milk. Even butter purchases were minor during 1994 and 1995. During this period, cheddar cheese prices were above the support price, except for a short period, November 1990 to April 1991. Market forces and not the support price have been determining dairy product prices and producer milk prices most of the time.

The current milk supply-demand situation is the tightest it has been for some time. Cheese prices are well above support; butter prices, although currently at support, will soon rise and be above support; nonfat dry milk prices may remain above, but close to support most of the time.

The result is that producer milk prices will average well above 1995 prices and well above support. The continuation of weather related milk production problems experienced in 1995 and high grain and concentrate prices in 1995/96 has substantially slowed milk production. But commercial disappearance remains strong. This all spells higher dairy product prices and producer milk prices for 1996 and on into 1997.

The $10.10 per hundredweight support price, and the $10.35 support price for 1996 under the Act, offers a very low safety net to producer milk prices. As a result, producer milk prices have and will continue to be volatile, but the trend is not for substantially lower milk prices during the 1996-2002 period. Assuming normal crop conditions, milk production will improve by 1997/98 and producer milk prices will decline form 1996 levels. But, milk prices will still be well above the $10.00 per hundredweight level.

As the support program is phased down and eventually eliminated, nonfat dry milk prices are likely to decline. The support price on nonfat dry milk at $1.065 per pound is above world prices which are expected to be in the $.80 to $.90 per pound range. But butter prices may not decline. The support price on butter has been at $.65 per pound, below expected world butter prices of $.70 to $.80 per pound. World butter prices were well above this level during the fall of 1995. Cheese prices may decline as some milk is shifted from lower value nonfat dry milk production to cheese production.

Perhaps the greatest impact of eliminating the support price will be on the states of California and Washington, the two major nonfat dry milk producers. California makes about 35 percent of all nonfat dry milk and Washington about a fourth. Declining nonfat dry milk prices will reduce the ability of the nonfat dry milk plants to pay their producers competitive prices. California is also the leading butter producer. When butter is in surplus, the major share of CCC butter purchases come out of California. Without a CCC purchase price for butter, there is more price uncertainty. Both butter manufacturers and butter buyers may be less willing to carry butter inventories when there no longer is a price support floor. Thus, the elimination of the support program will subject California and Washington butter and nonfat dry milk manufacturers, as well as manufacturers in other states, to more price risks and the challenge of paying their producers competitive prices.

Recourse Loan Program. In place of the support program, on January 1,2000 and through 2002, the secretary shall make recourse loans available to commercial processors of butter, nonfat dry milk and cheddar cheese. The purpose of the loans is to assist the processors to manage inventories of these dairy products and thereby provide some price stability. The amount of the loan will reflect a milk equivalent value of $9.90 per hundredweight of milk containing 3.67 percent milk fat. Assuming a loan price of $.65 per pound on butter, the loan price for nonfat dry milk would be about $1.00 per pound, and for 40 pound block cheddar cheese, $1.09 per pound. The period of the loan may not extend beyond the end of the fiscal year in which the loan is made. At the end of the fiscal year, the secretary may extend the loan for an additional period not to exceed the end of the next fiscal year.

A processor of nonfat dry milk, for example, may apply for a loan to help carry the inventory of nonfat dry milk from spring to the fall when demand normally increases and prices rise. The processor could then sell the nonfat dry milk and pay back the loan. Since this is a recourse loan, the processor is obligated to pay back the loan at full value plus interest even if market prices are below the loan price.

Dairy Exports. The 1996 Act extends the Dairy Export Incentive Program (DEIP) through 2002 and at fully funded Uruguay Round (GATT) limits. Although allowable dairy export subsidies under DEIP decline each year, this action will still assist the exports of nonfat dry milk and help to maintain its price.

Further, under the Act the secretary of agriculture may allocate the rate of price support between the purchase prices for nonfat dry milk and butter in a manner that will result in the lowest level of expenditures under the support program or achieve such objectives as the secretary considers appropriate, one of which may be exports of nonfat dry milk. It seems logical that the secretary may increase butter prices and lower nonfat dry milk prices to reduce the potential purchases of surplus nonfat dry milk, and to assist, along with the DEIP, exports of nonfat dry milk. One of the major rationales for phasing down the price support program was to allow time for the industry to develop stronger export markets.

The Act further encourages the export of dairy products. First, the Act requires the secretary to assist the industry to establish and maintain one or more export trading companies under the Export Trading Company Act of 1982 for the purpose of facilitating the international market development of dairy products. This export trading company may include both dairy cooperatives and investor owned firms. If the dairy industry has not established an exporting trading company on or before June 30,1997, or the quantity of exports of dairy products during the 12-month period preceeding July 1,1998 does not exceed the quantity of exports during the 12-month period preceding July 1, 1997 by 1.5 billion pounds, milk equivalent total solids basis, the secretary shall indicate which entity or entities autonomous of the Government, which seek such designation, is best suited to facilitate this international market development and export activity.

Second, the Act authorizes the National Dairy Promotion and Research Board to use a portion of their funds for export market development for each of the fiscal years 1997 through 2001. The Dairy Board has already benn doing this.

The secretary shall also conduct a study, on a variety-by-variety of cheese basis, to determine the potential impact on milk prices in the United States, dairy producer income, and federal dairy program costs, of additional cheese granted access to the United States as a result of GATT obligations. The report is due no later than June 30, 1997 to the Committee on Agriculture, Nutrition, and Forestry of the Senate and the Committee on Agriculture of the House of Representatives.

California Make Allowance. The Act appeals section 102 of the 1990 Farm Bill. Section 102 essentially stated that no state could have a pricing system that used a make allowance, the cost to convert 100 pound of milk into a manufactured dairy product, that exceeded the make allowances used under the federal dairy price support program, $1.22 for butter/powder, and $1.37 for cheese, both per hundredweight of milk. Section 102 was targeted primarily at California's state order. For a variety of reasons, Section 102 was never implemented.

The relatively large make allowances used in California's state price order, about $2.00 for cheese and $1.80 for butter/powder, resulted in lower cost to California plants of grade A milk used to make these products than the cost of Grade A milk to manufacturers in the Upper Midwest. This placed Upper Midwest manufacturers at a competitive disadvantage in competing with California nationally in marketing these dairy products. The Upper Midwest pushed hard for a national uniform cost of milk used for manufacturing. California fought hard to retain their existing make allowances and resulting lower milk cost.

The 1996 Act does partially address this problem. Under the Act no state shall provide for a make allowance in excess of $1.65 per hundredweight for milk manufactured into butter and nonfat dry milk, and $1.80 per hundredweight for milk manufactured into cheese. The make allowance will be determined by the difference between the value of milk per hundredweight as calculated by using the State's yield and product price formulas for butter and nonfat dry milk, and for cheese, and the class price for the milk used to produce those products. Hence, California can adjust its product pricing formulas for class 4a (butter and nonfat dry milk) and for class 4b (cheese) to partially reduce the impact of these lower make allowances. In fact, California has done just that.

Effective April 1,1996, California will adjust its make allowances for calculating minimum plant pay prices for both Class 4a (butter and nonfat dry milk) and Class 4b (cheddar cheese) milk. The make allowance for nonfat dry milk will be reduced from 16 cents per pound to 14 cents per pound. This in effect reduces the butter/powder make allowance from about $1.80 per hundredweight of milk to $1.61. The impact of this lower make allowance is partially offset by two other adjustments in calculating the minimum Class 4a price. In place of the Chicago Mercantile Exchange price for Grade AA butter, the California weighted average Grade AA butter price, which usually is lower, will be used. This change however, will be of little significance because prior to this change a freight allowance of $.05 per pound was subtracted from the Chicago Mercantile Exchange butter price. This net price, however, could not be lower than the CCC purchase price on butter. According to the California Department of Food and Agriculture (CDFA), the net effect of all of these adjustments is an increase in the class 4a price of about $.19 per hundredweight of milk.

Effective April 1, 1996, California's make allowance for calculating the class 4b price will be reduced from 19.5 cents per pound of cheese to 18 cents per pound. This in effect reduces the cheese make allowance from an average of about \$2.00[3] per hundredweight of milk to \$1.79. This change may be partially offset by three other adjustments. First, in place of using the National Cheese Exchange (NCE) 40 pound cheddar block price in the formula to calculate the minimum class 4b price, the California weighted average cheddar cheese price, which normally is lower, will be used. Second, a moisture adjustment factor of 1.0377, which was intended to reflect any premiums including moisture earned by cheese makers beyond the support price or the NCE price, is eliminated. Third, the use of the ratio of the NCE 40 pound cheddar block price to the CCC purchase price is eliminated as a "mover" of the base price for cheese in the formula. Prior to this change, if the NCE price, for example, was \$1.30 per pound compared to a support price of \$1.12 per pound, the base cheese price would be multiplied by \$1.30/\$1.12 or by a factor of 1.16. Again, according to CDFA, the net effect of these changes will average about \$.05 per hundredweight higher price for milk going into cheese.

These changes in California make allowances may reduce some of the competitive price disadvantages of Upper Midwest butter/powder and cheese manufacturers. The concern over expanded milk production in California as a result of higher producer prices is not warranted. For one, these increases in Class 4a and Class 4b prices will only amount to about \$.10 per hundredweight on producer blend prices. Further, rising feed costs to California producers will more than offset the resulting price increase and not encourage milk expansion.

If the secretary determines following a hearing that a State has in effect a make allowance that exceeds the allowances established under the Act, the secretary shall suspend purchases of cheddar cheese, butter, and nonfat dry milk produced in that State until such time as the State complies with the Act. The impact of all of this may be minor. For one, since the State's product price formula is used to measure the make allowance, this product price formula could be adjusted to meet compliance. As already indicated, California has done this effective April 1, 1996. Second, if a state so chooses, it could ignore the make allowances established under the Act. Any butter, nonfat dry milk or cheese produced in the state could be sold commercially, perhaps some at a discount to clear the market, rather than to the CCC under the support program. Such action would depress the respective product prices nationally. And finally, this action only applies during 1996-99 when the support program is still in effect.

Net Impact of Price Support & Export Provisions. The only real immediate beneficial impact of the dairy support program and dairy export provisions of the 1996 Act will be the elimination of producer assessments. Not only will the \$.10 assessment per hundredweight end on April 30,1996, those producers who do not increase their milk marketings in calendar year 1996 above calendar year 1995, may request a refund of the 1996 assessments. Further, without

[3] California's make allowance used for class 4b averaged near \$2.00 per hundredweight, but it varied depending upon the National Cheese Exchange 40 pound block cheddar cheese price. As the cheese price increased (decreased) the make allowance increased (decreased). In fact, with NCE 40 pound cheddar blocks at \$1.3925 per pound in March, the March cheese make allowance was \$2.32 per pound.

the provisions of the Act, on May 1, 1996 the $.10 per hundredweight assessment would have been increased to fund the refunds of 1995 assessments to those producers who had not increased 1995 milk marketings above 1994 marketings and who had requested refunds. Because of weather-related milk production problems, there were a number of producers who had reduced milk marketings in 1995 and will be receiving refunds of 1995 assessments. To fund these refunds, perhaps the May 1,1996 assessments would have been increased to near $.20 per hundredweight from May 1 to December 31,1996. The elimination of such assessments in 1996 will total about $1,400 to $1,500 for the average Wisconsin dairy producer marketing about 850,000 pounds of milk.

Exports will benefit dairy producer prices to the extent dairy exports are increased. Exports will tighten domestic dairy supplies and enhance producer milk prices. Additional dairy exports will develop slowly and, therefore, major price impacts will likely be minor. But there will be export potential, especially for butter which has been price competitive internationally, for nonfat dry milk under DEIP assistance, and for some value added cheeses and other dairy products. If dairy exports do in fact increase by 1.5 billion pounds by July 1,1997, the specified quantity under the special export trading company provisions of the Act, this would definitely have a positive impact on producer milk prices, perhaps $.25 to $.30 per hundredweight.

Federal Milk Marketing Order Provisions

Order Consolidation. The FAIR Act obligates USDA to reduce the number of federal orders to no more than 14 and no fewer than 10 within three years of enactment (by April 1999). This is the primary federal order provision in the new Act. Order consolidation through mergers has been occurring for many years. The mandate will speed the process.

Mandated consolidation will reduce the number of orders by 1/2 to 2/3. The effect of consolidation is unknown. By itself, it is not expected to have a major impact on regional milk prices. Depending on how and where order boundaries are drawn, some producers could experience a small gain from higher Class I utilization; others could show a small loss. There will be spirited debate in the consolidation hearings over where to draw the boundaries. Regions will attempt to avoid affiliation with low-utilization markets in the Upper Midwest.

Inclusion of California as a Separate Order. California, which currently has its own milk pricing program outside the federal order system, may become one of the 10-14 orders if California producers petition and approve of a federal order. If California elects to initiate an order, then it will be allowed to reblend order dollars in a manner consistent with its Class I quota and base provisions.

California's milk pricing and pooling plan is similar in concept to the federal order program and was initiated at about the same time as the Agricultural Marketing Agreement Act authorized federal orders. But in the 1960s, California adopted a milk base/quota system within its pricing and pooling plan that allocated higher-valued milk receipts to quota holders. The total amount of quota is fixed, but quota trades freely among producers. Consequently, the value reflects the capitalized value of the difference between higher class milk prices and lower class prices. Federal orders use market-wide pooling to distribute milk receipts, not quotas. This inconsistency, especially the possibility of quota value falling to zero, has served as a strong deterrent to California's joining the federal order system.

The permissive language of the new Act would allow California to continue to allocate the highest-valued milk receipts to quota-holders as a separate federal order market. This may encourage California to replace its state order with a federal order, which would lend consistency to milk pricing. But there are other substantive differences between California and federal order milk pricing that will still likely stand as barriers to uniform milk pricing.

Pricing suggestions. The order consolidation process will require hearings to hear testimony on appropriate boundaries and the method of setting classified prices within the new orders. The new Act authorizes USDA to consider the use of utilization rates and multiple basing points for pricing fluid milk. Further, USDA is authorized to consider the use of uniform multiple component pricing when developing basic formula prices for manufacturing milk.

These are desirable suggestions. The Upper Midwest has long criticized the use of Eau Claire as the single basing point to establish Class I milk prices in orders east of the Rocky Mountains. Using more than one basing point could represent an improvement, depending on the location of the basing points and the Class I differentials at the basing points. Multiple basing points would more efficiently route milk from areas with supplies in excess of Class I needs to deficit markets.

Class I utilization instead of distance is an even better criterion for varying Class I prices. Utilization-based differentials (part of Gunderson I) recognize the higher balancing costs associated with high fluid utilization markets. They are also flexible in response to changing supply and Class I needs.

The current Basic Formula Price (BFP), tied to a rapidly-disappearing Grade B milk supply, has a very limited life. The new Act recognizes the need to use a different method to price manufacturing milk. While the terminology is not entirely clear, the presumed intent is to ensure that producers are paid for their volume of milk components and that component values are tied to related product prices.

Unfortunately, these pricing suggestions are not mandates. It remains to be seen how the suggestions are used in USDA's order decision process. Experience to date is not encouraging. In the 1990 national order hearing process, USDA rejected any changes in Class I pricing, staunchly defending the status quo. In 1992 hearings to replace the M-W price as the basic formula price, USDA refused to hear proposals that would have altered Class I pricing, and ultimately decided to use a replacement that was obsolete before it became effective.

Expedited Process. USDA is required to implement order consolidation within three years and is granted special rule-making authority to shorten the time necessary achieve changes. USDA must announce proposed amendments no later than April 1998 and the amendments must become effective by April 1999. This time frame would be lengthened by the period of injunction if any judicial action enjoined either the announcement or implementation of amendments.

There is also a small "hammer" (short-handled tackhammer) in the Act to help ensure timely order consolidation. If the new orders are not in place within the specified time frame, then USDA may not collect assessments from handlers for order administration. In that event, USDA would be obligated to continue providing administrative services, but would have to fund the costs from the appropriated budget of the Agricultural Marketing Service.

USDA Study. USDA is required to submit a report on federal milk orders to Congress by April 1, 1997. The report is to contain a review of the order system in light of the consolidation mandate. It must also outline the progress toward consolidation to date and recommend order improvements and reforms beyond consolidation.

Other Major Provisions

California Fluid Milk Standards. For many years, California has imposed standards of identity for fluid milk that involve substantially higher solids-not-fat contents than federal standards. For lowfat milks (2-percent and 1-percent), the standards are designed to maintain total milk solids (butterfat plus nonfat) at 12 percent. This requires fortification of milk with condensed skim milk or nonfat dry milk. California dairy producer groups argue that fortification results in higher-quality, more tasty fluid products, and enhances demand for lowfat items.

Recent passage of federal nutritional labeling and uniform standards laws placed the California standards in jeopardy. The FAIR Act specifically exempts the state from conforming with federal laws regarding standards of identity for or labeling of fluid milk products. While this assures California the right to keep nonfat standards for fluid milk higher than national minimums, it is not clear whether the state will be able to require packaged milk prooducts from out-of-state processors to meet the same standards.

The Northeast Compact. The FAIR Act consents to the Northeast Interstate Dairy Compact. This consent is the culmination of two years of effort by New England Senators and Representatives to allow their states to collectively set fluid milk prices higher than the federal order prices applying in that area. Compact titles were tied to several related and unrelated pieces of legislation. All past efforts were rejected, in part because of strong opposition by Upper Midwest legislators.

Upper Midwest objections to the Compact are grounded in its effect on the supply of milk for manufacturing purposes and the resulting effect on prices for manufactured dairy products.

The Compact sets fluid milk prices higher than federal order minimums. This decreases fluid milk consumption and, through an increase in the blend price to producers, increases milk production. Larger production and reduced fluid consumption add to the supply of manufacturing milk, lowering manufacturing milk prices both inside and outside the Compact area.

But while the Compact is objectionable to the Upper Midwest, several provisions of the FAIR Act diminish its potential negative impact. These include:

- The Secretary of Agriculture must make a finding that there is a "...compelling public interest in the Compact area..." before granting authority to implement the Compact. Since the Compact would raise milk prices to consumers above current levels, it is hard to see how such a public interest finding could be made. But time will tell.

- The Compact can only regulate Class I milk. There is a specific prohibition against regulating other classes of milk.

- The Compact will be in effect only until USDA has completed order consolidation (April 1999 or longer in the event of injunctions).

- States contiguous to New England (Delaware, New Jersey, New York, Pennsylvania, Maryland, and Virginia) may join the compact, but only if Congress specifically consents.

- The Compact must compensate USDA for any added cost of price support purchases resulting from an expansion in milk production in the Compact area that exceeds the national average increase.

- The Compact is prohibited from foreclosing milk from outside the area, either directly or though the use of compensatory payments for outside milk. Milk entering the Compact area must be priced and allocated to classes in the same manner as used in federal orders. This is the most restrictive of the limits on the Compact. If Compact prices were substantially out of line with those outside the area, then processors would have an incentive to obtain their fluid milk needs from outside dairy cooperatives, since their obligation to the compact or federal order pool would be the Class I price in the shipping market rather than the Compact price.

Promotion Programs. The Act extends to 2002 and slightly modifies the processor-funded Fluid Milk Promotion Act of 1990. It also extends and amends authorizing legislation for the National Dairy Promotion and Research Board (NDPRB). The NDPRB is authorized to spend monies to promote U.S. dairy products (made with milk produced in the U.S.) in international markets.

The Bottom Line

New dairy legislation offers some pluses and some minuses to Wisconsin dairy farmers. On the positive side, assessments are gone. Assessments have been a regular fixture of dairy policy since the early 1980s, when there was a legitimate surplus and a legitimate reason for their use. The latest round of assessments, a product of the 1990 farm bill, was not really necessary. Supply and demand have been in good balance. The projected government program costs that engendered the assessments were far off base. Compared to other commodities, dairy was treated unfairly in the Omnibus Budget Reconciliation Act of 1990.

Another plus is the phase-out of the dairy price support program, which has been part of dairy policy since 1949. It provided the unwarranted price stability and the unwarranted high prices that fostered the rapid growth of dairying in the Southwest in the late 1970s and early 1980s. It sent dairy farmers erroneous, politically-motivated signals to expand production, leading to a chronic surplus situation that took 15 years to rectify. It permanently altered regional milk production patterns and promoted the building of unnecessary manufacturing capacity. Terminating the price support program is a bit like locking the barn door after the horse has been stolen, but it is recognition that the government is not skilled in replicating marketplace conditions and marketplace discipline. And it is a precursor to further deregulation of milk pricing.

For those who mourn the loss of Dairy Price Supports because the program represented a safety net, remember that a safety net lying on the ground does not provide a lot of protection. Since at least 1990, the support price has been at a level that spells big-time losses for all dairy farmers. Maintaining the support program as an ineffective safety net is a very high price to pay given the market distortions that the program has created.

The negatives of the new dairy title are mainly in lost opportunities to reform federal milk marketing orders. Order consolidation is not order reform. The new FAIR Act offers tantalizing opportunities for order reform in suggesting alternatives to single basing point pricing. But it does not order them. Thus, we are faced with depending on USDA to protect the public interest by altering highly-distortive pricing rules that provide clear benefits to some and equally clear penalties to others. Given past experience, this is not an especially comforting prospect.