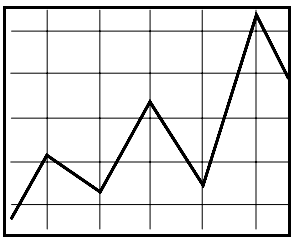
MARKETING AND POLICY BRIEFING PAPER



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Dairy Subtitle: Food, Conservation, and Energy Act of 2008

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Introduction

The Food, Conservation, and Energy Act of 2008 was enacted by Congress on May 22 after both the Senate and House voted to override President Bush's veto of the bill on May 21.[2] The administration objected to the $300 billion cost of the farm bill programs and, in particular, the unwillingness of Congress to seriously limit commodity payments to high-income recipients. Attempts to reach a compromise between the Administration and Congress began shortly after Senate passage of their bill in mid-December 2007 and continued until passage of the conference bill in mid-May. Progress was made in cutting authorized expenditures, and tightening eligibility requirements, but not enough to satisfy the White House.

In contrast to the last two farm bills, dairy was NOT the cause of the lengthy delay in enacting the 2008 Agricultural Act.[3] No major changes from current programs were

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[2] Actually, only 14 of the 15 titles of the Farm Bill became law on May 22. Title III (Trade) was inadvertently omitted from the version of the Bill that the President vetoed, which veto was over-ridden by Congress. A parliamentary decision enacted the 14 titles that were dealt with and left the Trade Title in limbo at this writing.

[3] The 1996 farm bill involved regional frictions related to proposed changes in milk marketing orders and creation of the Northeast Interstate Dairy Compact. In 2002, attempts to reinstate the compact reignited regional differences and ultimately led to the MILC program. For historical background, see Jesse and Cropp, Dairy *Title, Federal Agricultural Improvement and Reform Act of 1996*, Marketing and Policy Briefing Paper No. 55, April 1996; and Jesse and Cropp, *Dairy Title: Food Security and Rural Investment Act of 2002*, Marketing and Policy Briefing Paper No. 76, May 2002. These publications are available from the Understanding Dairy Markets website, Marketing and Policy Briefing papers section: http://future.aae.wisc.edu/pubs/categories/show/1 .

proposed by either the House or Senate, and their respective versions of the farm bill were very similar. Reconciliation in the conference committee was harmonious, and the delay benefited dairy interests and their Congressional supporters by giving time to make changes in the MILC program that resulted in a more realistic target price for triggering payments to dairy farmers.

Highlights of the new dairy subtitle include:

- The Milk Price Support Program is re-named the Dairy Product Price Support Program. USDA continues to purchase butter, nonfat dry milk and cheddar cheese to at the same prices applicable under previous legislation, but the prices are no longer linked to a support price for milk.

- The Secretary of Agriculture MAY reduce the purchase prices for butter, nonfat dry milk, and cheese if government removals exceed specified levels in any 12-month period. This provision replaces the butter-powder tilt provision in the last three farm bills.

- The Milk Income Loss Contract (MILC) program is reauthorized and altered to adjust the Class I target price using changes in feed costs. The portion of the amount by which the market price falls short of the target price that is paid out on eligible milk is raised from 34 to 45 percent and the production cap is raised from 2.4 million pounds annually to 2.985 million pounds.

- The farmer-funded dairy promotion program is changed to require assessments be collected from previously-exempted dairy farmers in Alaska, Hawaii and Puerto Rico. Imports will be assessed at a rate one-half the rate applying to U.S. milk production.

- The Dairy Forward Pricing program that operated on a pilot basis from 1999 through 2004 is reinstated as part of the new Farm Bill.

- The Dairy Export Incentive Program (DEIP) and the Dairy Indemnity Program are extended intact.

- USDA is required to establish an electronic system for mandatory reporting of dairy product inventories and sales information and to increase the frequency of reporting once the electronic reporting system is operational.

- USDA is required to take steps to expedite the process of amending Federal Milk Marketing Orders.

- USDA is required to study the impact of trade misreporting of nonfat dry milk prices and sales volume on Federal Order minimum prices.

- Congress created a Federal Milk Marketing Order review commission to evaluate current federal and state milk pricing regulations and provide related recommendations for change to Congress.

Section-by-Section Description and Analysis

Dairy Product Price Support Program

The 2008 Farm Bill makes a definitional change in the federal dairy price support program: the *Milk* Price Support Program is renamed the *Dairy Product* Price Support Program. USDA's Commodity Credit Corporation (CCC) will still purchase cheddar cheese, butter and nonfat dry milk, but the CCC purchase prices for these products are no longer linked to a specified support price per hundredweight of manufacturing milk.

Before analyzing this change, a short review of how the Milk Price Support Program functioned may be useful. The price of manufacturing use milk has been supported continuously since passage of the Agricultural Act of 1949. This Act required the Secretary of Agriculture to support prices received by dairy farmers for manufacturing use milk at between 75 percent and 90 percent of parity. The specific parity level within this range was determined by forecasting the adequacy of future milk production in fulfilling market needs. Parity attempted to keep the same relationship between milk prices and farm costs as existed in the period of 1910-14. The parity formula used the *Index of Prices Paid* by farmers to adjust the parity price for milk. Using assumed yields and manufacturing costs, the support price for manufacturing use milk was converted into a price per pound of cheddar cheese, butter and nonfat dry milk. The CCC stood ready to purchase unlimited quantities of cheddar cheese, butter and nonfat dry milk at these prices to keep the price of manufacturing use milk from falling below the support level. The assumption was that if cheese, butter and nonfat dry milk plants received these prices, then they would be able to pay dairy farmers at least the support price for their milk.

The 1949 Agricultural Act has been amended from time to time. In 1973, the minimum support level was raised from 75 percent to 80 percent of parity. The Agricultural and Consumer Protection Act of 1977 continued the minimum support level of 80 percent of parity through April1, 1981 and required that the support price be adjusted semi-annually (October 1 and April 1) to reflect changes in the Index of Prices Paid by farmers. Inflation during the 1970s, plus the fact that the parity formula ignores changes in productivity at the farm, resulted in the support price increasing from $4.28 per hundredweight on October 1,1970 to $13.10 per hundredweight on October 1,1980. Dairy farmers responded by increasing milk production far beyond commercial use. Surplus dairy products purchased by the CCC under the support program approached 10 percent of all farm marketings and associated government costs approached $2 billion annually (see Figure 1).

This surplus situation resulted in a major change in the support program. The Agriculture and Food Act of 1981 removed the support level from parity. The support price would now be tied to both the level of CCC purchases and associated net government cost of the program. Under these provisions and subsequent amendments, the support price was gradually lowered. The Food, Agriculture, Conversation and Trade Act of 1990 set a minimum $10.10 per hundredweight support price through 1995. The Federal Agricultural Improvement and Reform Act of 1996 increased the support price to $10.35 per hundredweight for 1996, with subsequent reductions of $0.15 each January 1 to $9.90. Further, the Act required termination of the program on December 31, 1999. Subsequent legislation extended the program until May 2002, when the Farm Security and Rural Investment Act of 2002 reinstated the program through 2007 at the $9.90 per hundredweight support level.

Even though the support level was reduced to the low level of $9.90 per hundredweight and there have been no CCC purchases of surplus dairy products since 2004, WTO still scores the dairy support program as a major subsidy to dairy farmers. Under the last WTO agreement (the 1994 Uruguay Round) the contribution of the dairy price support program to the Aggregate Measure of Support (AMS) is measured by the difference between the $9.90 per hundredweight support price and a world price of $7.25 per hundredweight (average price for 1986-88) multiplied by total U.S. milk production. For 2007, this calculation yields $4.9 billion ($2.65 per hundredweight X 1.856 billion hundredweight of milk). Under the WTO agreement, the AMS upper limit for all of U.S. agriculture is $19.1 billion annually. Thus, the dairy price support program alone contributes more than 25 percent to this limit.

The change from a Milk Price Support Program to a Dairy Product Price Support Program is an attempt to circumvent this method of calculating dairy's contribution to AMS. No longer is U.S. supporting a specific milk price to dairy farmers, but rather is supporting the price of three dairy products. Specially, the 2008 Farm Bill states, "During the period beginning on January 1, 2008, and ending December 31, 2012, the Secretary shall support the price of cheddar cheese, butter, and nonfat dry milk through the purchase of such products made from milk produced in the United States." Initially these CCC purchase prices per pound are identical to the prices that were used to support the $9.90 per hundredweight support price: $1.13/lb for 40-pound cheddar blocks, $1.10/lb for cheddar barrels, $1.05/lb for butter and $0.80/lb for nonfat dry milk.

There is a potentially significant difference between supporting a specific milk price and supporting dairy product prices. Under the Milk Price Support Program the support price per hundredweight of manufacturing use milk was converted into CCC purchase prices per pound that, on the average, would enable a cheddar cheese or butter-powder plant to pay dairy farmers at least the support price. The 1990 farm bill instructed the Secretary to use butter-powder tilts to minimize the public cost of the dairy price support program. Butter and nonfat dry milk were considered joint products. In the early 1990s, butter was in surplus relative to nonfat dry milk. Four tilts were made between April 1990 and July 1993, when the support price was constant at $10.10 per hundredweight. The butter purchase price was decreased from $1.0925 to $0.65 per pound and the nonfat dry milk

price was correspondingly increased from $0.79 to $1.034 per pound in order to maintain the $10.10 per hundredweight value for milk used to make butter and nonfat dry milk. Butter-powder tilts were re-authorized by subsequent farm bills to permit the Secretary to minimize the purchase and storage costs of surplus dairy products. Beginning in 2000, nonfat dry milk was in surplus relative to butter and the Secretary implemented two tilts, one on May 31, 2001 and another on November 15, 2002. These tilts reduced the support price on nonfat dry milk from $1.032 to $0.80 per pound and correspondingly increased the support price of butter from $0.6549 to $1.05 per pound in order to maintain a $9.90 per hundredweight support price.

Under the Dairy Product Price Support Program CCC purchase prices of cheese, butter and nonfat dry milk will no longer be tied to a specific per hundredweight support price. For example, if butter was in surplus relative to nonfat dry milk, the CCC purchase price for butter may be lowered, but no longer would the purchase price of nonfat dry milk be correspondingly increased to maintain a specific support price per hundredweight of milk. The issue of butter-powder tilts no longer exists.

Provisions of the 2008 Farm Bill state that the Secretary *may* reduce the purchase price of cheddar cheese, butter or nonfat dry milk, if CCC net removals for a period of 12 consecutive months exceed in Table 1.[4]

Table 1. Authorized Reductions in CCC Purchase Prices if Net Removals for 12 Consecutive Months Exceed Specified Trigger Amounts

Product	***Net Removals Trigger:***	***Maximum Authorized Price Reduction per Pound***
Cheddar cheese	Greater than 200 million pounds, but less than 400 million pounds	10 cents
	Greater than 400 million pounds	20 cents
Butter	Greater than 450 million pounds, but less than 650 million pounds	10 cents
	Greater than 650 million pounds	20 cents
Nonfat dry milk	Greater than 600 million pounds, but less than 800 million pounds	5 cents
	Greater than 800 million pounds	10 cents

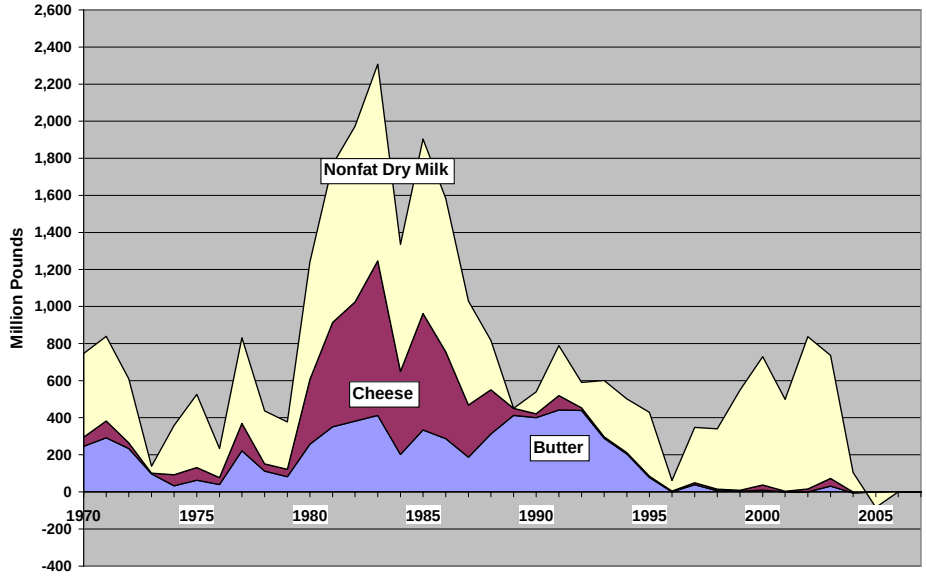
[4] Net removals differ from annual CCC purchases under the price support program. Net removals equal price support purchases plus DEIP removals minus unrestricted sales back into the market.

The probability is extremely low that net removals will reach levels triggering possible reductions in the purchase prices for two reasons. First, the CCC purchase prices are so low that if reached, farm milk prices would be well below the cost of production, leading to a quick supply response.

Second, except for a few years, CCC annual purchases have been well below levels that would authorize price reductions in the 2008 Act (See Figure 1). Since 1990, CCC net removals of butter never reached the lower range of 450 million pounds that would authorize up to a 10 cent reduction in the purchase price. Since 1990, CCC net removals of cheddar cheese never reached the lower limit for 200 million pounds that would allow the Secretary to reduce the purchase price by 10 cents. Since 2004, there have been no purchases of cheddar cheese under the price support program. Since 1990 the only significant purchases under the price support program have been nonfat dry milk and these peaked during 2000 to 2003 period. From 1990 through 2007 there were only three years (2000, 2002 and 2003) when net removals of nonfat dry milk reached the lower limit of 600 million pounds, which would allow the Secretary to reduce the purchase price by 5 cents, and only one year (2003) when CCC purchases reached the upper limit of 800 million pounds allowing up to a 10 cent reduction in the purchase price. There have been no CCC purchases of nonfat dry milk under the price support program since 2005, and export markets for U.S. nonfat dry milk and skim milk powder are expected to remain strong over the next several years.

Similar to previous Farm Bills, the Secretary is authorized to sell back to the market any CCC inventory of butter, cheddar cheese or nonfat dry milk available for unrestricted use. But, the sale price may not be less than 110 percent of the CCC purchase for the product.

Figure 1. Government Purchases of Dairy Products



How the WTO will view the change in diary price supports in calculating the U.S.S is unknown. Since CCC purchase prices of cheddar cheese, butter and nonfat dry milk are initially the same as those used for the $9.90 per hundredweight support price, WTO might interpret this as no change, and, therefore, that dairy's contribution to the AMS has not changed. Another possibility is that WTO will calculate dairy's contribution to the AMS by subtracting world prices for cheese, butter and nonfat dry milk during the base years of 1986 -88 from current CCC purchases prices and multiply the difference by U.S. production of these three products. Under this approach the dairy product price support program in the 2008 Act would have contributed approximately $3.075 billion in 2007 to the U.S. AMS (Table 2).[5] While this is below the $4.93 billion attributed to the price support program that existed prior to the 2008 Farm Bill, it is still sizeable.

Since the U.S. has a classified pricing system with Federal Milk Marketing Orders and the California state order also uses classified pricing, WTO may view the actual contribution to the AMS much higher. Cheddar cheese, butter and nonfat dry milk prices are used in product price formulas to calculate federal order Class III and Class IV prices and California's 4a and 4b prices. In turn, these manufacturing milk prices underlie prices for other classes of milk. Thus, the level of cheddar cheese, butter and nonfat dry milk prices support the price of nearly all U.S. milk production.

Table 2. Estimated U.S. Dairy Product Support Program's Contribution to the WTO Aggregate Measure of Support Based on Production in 2007 and 1986-88 World Commodity Prices

	Butter	***Cheese***	***Nonfat dry milk***
CCC purchase price per pound	$1.05	$1.13	$0.80
Minus World price per pound (1986-88 avg.)	$0.53	$0.656	$0.535
	$0.507	$0.474	$0.265
Times U.S. production (billion pounds)	1.533	3.057	3.015
Equals Contribution to AMS ($Mil)	$777.2	$1,499.2	$798.9
Total contribution to AMS, all products	**$3.075 bil.**		

If WTO used more current world prices (which would be the case under a new Doha Round agreement), then the dairy product price support program's contribution to AMS would be negligible. Currently, world market prices for cheese, butter and nonfat dry milk are all well above the CCC purchase prices specified in the new Act.

[5] Estimated world prices were drawn from GATT, "The World Market for Dairy Products", 1986-88. But, caution should be used with these prices. There was inconsistency in how prices were reported by countries. Actual world prices may be higher or lower than what are shown in the table.

In summary, changing from a Milk Price Support Program to a Dairy Product Price Support Program may reduce U.S. dairy support program's contribution to AMS. But that would seem to be the only potential benefit of the revamped system of dairy price supports. The CCC purchase prices are so low relative to market price projections over the next five years that there is little chance of significant purchases.

Milk Income Loss Contract Program

The Milk Income Loss Contract (MILC) program under the 2008 Farm Bill is similar to that authorized under the 2002 Farm Bill and subsequent MILC-X extension.[6] The objective of the program is to provide direct payments to dairy farm operators on eligible milk marketings whenever the Boston Class I milk price falls below a target level.

The differences between the MILC program in the new Act and the version it replaced are in the manner in which the target price is defined, the price deficiency payment rate (the percentage of the difference between the target price and the market price that is paid to producers), and the cap on eligible milk marketings during any fiscal year.

Adjustment to the Class I Target Price

The major new Farm Bill change in MILC is adoption of a feed cost adjuster to the target Class I price. The adjuster is based on the estimated cost per hundredweight of a 16 percent protein dairy ration that USDA uses to calculate the Milk-Feed Price Ratio. By weight, the ration consists of 51 percent corn, 41 percent alfalfa hay, and 8 percent soybeans. U.S. average prices for these commodities as reported in USDA's *Agricultural Prices* are used to calculate the ration value referred to as the *National Average Dairy Feed Cost*. The initial base feed cost is $7.35/hundredweight, increasing to $9.50/cwt in September 2012.

The feed cost adjustment to the target MILC target price is calculated as follows: at the end of each month, USDA will calculate the monthly value for the National Average Dairy Feed Cost and compare the value with the base $7.35. If the current dairy ration cost is less than or equal to $7.35, then the MILC Class I target price will be $16.94. If the current value is higher than $7.35, then the percentage difference between the current ration cost and $7.35 will be multiplied by 45 percent (the proposed payout rate for MILC deficiency payments) and the resulting percentage will be used to increase the $16.94 target for the previous month.

As an illustration of how the proposed trigger mechanism would work, consider the MILC target price for April 2008.[7] The April 2008 feed prices reported by USDA in

[6] A description of the original MILC program can be found in Jesse and Cropp, 2002. *Dairy Title: Farm Security and Rural Investment Act of 2002*, Marketing and Policy Briefing Paper #76, Department of Agricultural and Applied Economics, University of Wisconsin-Madison, May. This paper can be accessed at: http://future.aae.wisc.edu/pubs/pubs/show/19 .

[7] A spreadsheet used to undertake the April calculations can be downloaded at: http://future.aae.wisc.edu/collection/software/MILC_Cost_Adjuster.xls .

Agricultural Prices were Corn: $5.13/bushel ($0.0916/pound for a 56-pound bushel), Alfalfa: $157/ton ($0.0785/pound), and Soybeans: $11.80/bushel ($0.1967/pound for a 60-pound bushel). Applying the weights noted above yields a ration value of $9.46/hundredweight. Subtracting $7.35 yields $2.11, or 28.7 percent higher than the target feed cost. The percentage increase in the MILC target price would be 45 percent of 28.7 percent, or 12.9 percent. Therefore, the April 2008 MILC target price would be calculated as (1.129*$16.94) = $19.13.

Table 3 illustrates the mechanics of the new MILC program. The table provides a retrospective of monthly feed costs and implied MILC target price from January 2007 through April 2008 if the MILC program authorized by the 2008 Farm Bill had been in effect. Note there would have been no adjustment to the MILC target price until December 2007, when the National Average Dairy Feed Ration Cost went above the $7.35 base. With the dramatic increases in each of the three feed cost factors during the first four months of 2008, the ration cost was $2.11 over the $7.35 target by April, a difference of 28.7 percent. Nonetheless, the imputed cost-adjusted Class I mover would not have been high enough to trigger MILC payments.

Table 3. Evaluation of New MILC Program, January, 2007 – April, 2008

Month	*Feed Costs*				*Feed Cost Less Target*		*Imputed MILC Target ($/cwt)*	*Class I Mover*		
	Corn ($/bu)	*Soy-beans ($/bu)*	*Alfalfa ($/T)*	*Ration Cost ($/cwt)*	*$/cwt*	*Percent*		*Imputed ($/cwt)*	*Actual ($/cwt)*	*Actual Less Imputed ($/cwt)*
1-07	3.05	6.37	112	5.92	-1.43	NA	16.94	13.69	13.59	-0.10
2-07	3.44	6.87	115	6.41	-0.94	NA	16.94	13.69	13.39	-0.30
3-07	3.43	6.95	121	6.53	-0.82	NA	16.94	13.69	14.25	0.56
4-07	3.39	6.88	127	6.61	-0.74	NA	16.94	13.69	15.00	1.31
5-07	3.49	7.12	145	7.10	-0.25	NA	16.94	13.69	15.92	2.23
6-07	3.53	7.51	137	7.02	-0.33	NA	16.94	13.69	17.84	4.15
7-07	3.32	7.56	137	6.84	-0.51	NA	16.94	13.69	20.91	7.22
8-07	3.26	7.72	137	6.81	-0.54	NA	16.94	13.69	21.76	8.07
9-07	3.29	8.18	135	6.85	-0.50	NA	16.94	13.69	21.91	8.22
10-07	3.29	8.36	137	6.92	-0.43	NA	16.94	13.69	21.59	7.90
11-07	3.43	9.41	135	7.15	-0.20	NA	16.94	13.69	21.45	7.76
12-07	3.76	10.00	136	7.55	0.20	2.7	17.14	13.89	20.04	6.15
1-08	3.97	9.96	135	7.71	0.36	4.9	17.31	14.06	20.97	6.91
2-08	4.53	11.70	138	8.51	1.16	15.8	18.15	14.90	19.68	4.78
3-08	4.70	11.50	143	8.75	1.40	19.0	18.39	15.14	16.70	1.56
4-08	5.13	11.80	157	9.46	2.11	28.8	19.13	15.88	18.61	2.73

Note: The Corn, Soybean and Alfalfa prices were obtained from USDA's monthly *Agricultural Prices*. For this time period, the National Average Dairy Feed Ration Cost target is set at $7.35. The Imputed Class I Mover is the Imputed MILC target price less the $3.25 Class I Boston differential. The Actual Class I Mover is the advanced Class I mover announced by USDA. The spreadsheet used to derive the values shown in this table can be found at: http://future.aae.wisc.edu/collection/software/milk_simulation_07_08.xls .

Feed costs continue to rise while milk prices have leveled off relative to 2007. This raises the question of whether MILC payments under the new system of calculating the target price can be expected anytime soon. To address this question, we used the May 23, 2008, futures settle prices for Corn, Soybeans and Class III milk over the July 2008 through May 2009 period as one possible price scenario.[8] For alfalfa hay, which does not have a futures contract, we assumed the same monthly hay prices as reported for the corresponding months of 2007/2008. For months with no listed corn or soybean futures contracts, we interpolated between the months with contracts.

Table 4 shows these projected feed prices and the resulting estimated National Average Dairy Feed Ration Cost. If these feed prices materialize, the National Average Dairy Feed Ration Cost would average $10.45 per hundredweight over the July '08 – May '09 period. This is $3.10 over the $7.35 feed cost base, which would yield an average MILC target price of $20.15 and an average related Class I mover target of $16.90. Given the average projected Class I mover (the Class III futures price) is $20.22, we would not expect any MILC payments through May 2009.

Table 4. Feed Costs and Class I Mover Targets, July '08 – May '09

Mo-Year	*Corn ($/bu)*	*Soybeans ($/bu)*	*Alfalfa ($/ton)*	*Feed Cost ($/cwt)*	*Feed Cost less $7.35 Target ($/cwt)*	*% Diff Over Target*	*MILC Target ($/cwt)*	*Class I Mover Target ($/cwt)*	*Projected Class I Mover ($/cwt)*
Jul-08	6.07	13.48	137	10.14	2.79	37.9	19.83	16.58	21.38
Aug-08	6.13	13.52	137	10.20	2.85	38.7	19.89	16.64	21.25
Sep-08	6.20	13.52	135	10.21	2.86	39.0	19.91	16.66	21.25
Oct-08	6.24	13.54	137	10.30	2.95	40.1	20.00	16.75	20.89
Nov-08	6.29	13.55	135	10.30	2.95	40.1	20.00	16.75	20.75
Dec-08	6.33	13.62	136	10.37	3.02	41.1	20.07	16.82	20.68
Jan-09	6.38	13.68	135	10.40	3.05	41.5	20.10	16.85	19.90
Feb-09	6.42	13.73	138	10.51	3.16	42.9	20.21	16.96	19.27
Mar-09	6.46	13.77	143	10.65	3.30	44.9	20.36	17.11	19.22
Apr-09	6.41	13.81	157	10.90	3.55	48.3	20.62	17.37	18.90
May-09	6.36	13.84	160	10.92	3.57	48.6	20.64	17.39	18.90
Average	6.30	13.64	141	10.45	3.10	42.1	20.15	16.90	20.22

Note: The Projected Class I Mover values are the Class III settle prices as of May 23, 2008.

Price Deficiency Payment Rate

The MILC program authorized by the 2002 Farm Bill specified a payment rate of 45 percent of any "deficiency" between $16.94 per hundredweight and the Boston Class I price. MILC-X reduced the payment rate to 34 percent starting in October 2005. The new Act initially uses this payment rate and then raises the rate back to 45 percent starting in October 2008 through August 2012, when the rate reverts back to 34 percent.

[8] We assumed that the Class III price will be the mover over this time period.

The peculiar starting and ending dates for reinstatement of the 45 percent deficiency payout is likely related to budget considerations.

Eligible Milk Production

Annual producer MILC payments are capped by limiting the amount of milk eligible for payment during any fiscal year. The cap since inception of MILC has been 2.4 million pounds per year. The new Farm Bill raises the cap to 2.985 million pounds for the period October 2008 through August 2012. Similar to previous rules, producers cannot opt into and out of the program. Once in, the producer must stay in until the production limit cap is met or the new fiscal year starts (i.e., October 1).

Table 5 shows the percent of total milk production, dairy cows and dairy farms by size groupings for the U.S. and Wisconsin. In 2007 average annual U.S. milk production per cow was 20,266 pounds and 19,305 pounds for Wisconsin herds. This implies that, on average, U.S. herds larger than 118 cows would have hit the 2.4 million pound cap, while the fully-eligible average herd size with the 2.985 million pound cap is 147 cows. For Wisconsin, the limit herd size using average milk per cow across all herd sizes increases from 126 to 157 cows.

Using average productivity values for 2007, we estimate that under the 2.4 million lb. production limit, 84 percent of Wisconsin's dairy herds are fully covered which accounted for 45 percent of Wisconsin's milk production. For the U.S., 79 percent of U.S. herds are fully covered accounting for 21 percent of milk production. For all farms, the MILC program with the 2.4 million pound cap would cover, in whole or part, about 68 percent of total Wisconsin total milk production and 40 percent of U.S. production

Based on the size distribution of Wisconsin dairy herds in 2007, we estimate that about 560 more herds (3.9 percent) in the state would be fully eligible for MILC payments with the higher cap.[9] The added Wisconsin milk production eligible for payment would be roughly 1.2 billion pounds (5.0 percent). Comparable estimates for the United States are 2,890 more fully-eligible herds (4.0 percent) and 7.5 billion pounds additional eligible milk production (4.0 percent). Thus with the higher MILC eligible production limit, we estimate that 88 percent of Wisconsin's herds and 83 percent of U.S. dairy herds will be fully covered. The higher limit raises the proportion of total Wisconsin milk production covered to 72 percent, and for the U.S., 44 percent.

[9] Estimates of the additional fully eligible herds assume a horizontal distribution of herds within the 100-199 cow size category.

Table 5. Size Distribution of U.S. and Wisconsin Dairy Herds, 2007*						
Herd Size (No. of Cows)	***No. of Herds***	***% of Herds***	***% of Milk Prod.***	***Avg. Production per cow (lbs/Year)***	***Max. No. of Cows Covered by 2.4 Mil. Lb. Limit***	***Max. No. of Cows Covered by 2.985 Mil. Lb. Limit***
U.S.						
1-29	20,015	28.0	1.2	14,306	29	29
30-49	13,420	18.8	4.5	16,000	49	49
50-99	20,980	29.3	13.1	17,240	99	99
100-199	9,325	13.0	12.2	18,452	130	161
200-499	4,555	6.4	14.9	20,267	118	147
500-999	1,700	2.4	12.3	19,942	120	150
1,000-1,999	920	1.3	16.1	24,533	97	122
2000+	595	0.8	25.7	22,528	106	133
All Herds	71,510	100.0	100.0	20,266	118	147
Wisconsin						
1-29	1,900	13.2	1.5	11,586	29	29
30-49	3,600	25.0	10.0	16,092	49	49
50-99	6,100	42.4	29.0	17,778	99	99
100-199	1,800	12.5	18.5	19,310	124	155
200-499	750	5.2	19.0	20,966	114	142
500+	250	1.7	22.0	23,602	102	126
All Herds	14,400	100.0	100.0	19,035	126	157

*Data from this table are drawn from the USDA-NASS Quick-Stats website. Herd sizes larger than 500 cows are not broken out for Wisconsin.

Dairy Forward Pricing Program

The 2008 Farm Bill requires the Secretary of Agriculture to establish a program under which dairy producers and dairy cooperatives are authorized to voluntarily enter into forward price contracts for future milk production with milk handlers (buyers of milk). The new program essentially replicates the pilot forward contracting program that operated between 1999 and 2004.

The program applies only to milk regulated under federal milk marketing orders and it does not apply to milk classified as Class I milk (milk for beverage use). To prevent the logistical problem of milk handlers with Class I milk needing to segregate or otherwise individually track the source and disposition of milk, a milk handler may allocate milk receipts from producers and cooperatives that are not subject to a forward contract to satisfy its quantity of Class I milk. For example, if a handler has 60 percent Class I, it could offer forward contracts with dairy producers or cooperatives on up to 40 percent of its total milk receipts.

Since the pilot forward contracting program expired, it has been difficult for order-regulated handlers that are not organized as a cooperative to offer forward contracts. Federal orders require such handlers to pay their producers no less than announced minimum prices, but cooperatives are exempt from this requirement.

Dairy plants — whether cooperatives or not — that forward contract at fixed prices with their patrons sell Class III futures contracts to protect their positions. If the announced Class III price ends up less than the contract price, then the contracting plant earns enough money per hundredweight from its futures market transactions to pay the higher price. If the announced Class III price is higher than the contract price, then the plant loses the difference in its futures transactions, and can only pay the lower contract price. But proprietary dairy companies were legally obligated to pay the higher federal order price, even though they incurred losses on futures market hedging transactions. Many creative arrangements were used to circumvent this problem. But because of their exemption from the minimum producer price rule, dairy cooperatives had an advantage in offering forward contracts to dairy producers.

A handler may not require participation in a forward price contract as a condition of the handler receiving milk from a dairy producer or dairy cooperative. The Secretary shall investigate complaints made by dairy producers or dairy cooperatives of coercion by handlers to enter into forward price contracts.

This contracting authority for handlers that are not a cooperative to enter into forward price contracts with dairy producers or dairy cooperatives expires on September 30, 2012. Further, no forward price contract entered into prior to this termination date can extend beyond September 30, 2015.

Dairy Export Incentive Program

The Dairy Export Incentive Program (DEIP) was authorized by the Food Security Act of 1985 as a means of promoting exports of U.S. manufactured dairy products and facilitating international market development and the removal of surplus dairy products purchased under the dairy price support program. DEIP was reauthorized in the 1990, 1996 and 2002 Farm Bills. The new Act further extends the program through December 31, 2012, and directs the Secretary of Agriculture to use the maximum export volumes and maximum funds permissible under the Uruguay round of the WTO agreement.

DEIP is a dairy export subsidy program. Products eligible for DEIP subsidies are milk powders, butter and butterfat, and several cheese varieties. Until recently, U.S. prices for these dairy products were above world market prices, meaning that exports without subsidies were unprofitable. DEIP sales are made by private firms. After contacting an eligible potential buyer, the exporter submits a bid to USDA requesting a cash DEIP bonus that would allow the sale to take place.

DEIP was used extensively during much of the 1990's to subsidize exports of nonfat dry milk. However, world market prices since for nonfat dry milk during the past 5 years

have generally been above the CCC purchase price and often above wholesale prices in the United States. The U.S. has become a major world supplier of nonfat dry milk at attractive prices, making DEIP subsides unnecessary. DEIP has never been a significant factor in butter and cheese exports, mainly because limits imposed under WTO are very small relative to nonfat dry milk.

Revision of Federal Marketing Order Amendment Procedures

The dairy industry has complained with increasing intensity and frequency about USDA's lengthy delays in issuing decisions on federal milk marketing order amendments. For example, USDA has yet to render a final decision from hearings held as long as three years ago.

In response to these complaints, Congress in the new Farm Bill requires USDA to establish and meet certain deadlines in the order amendment process. These include:

- Within 30 days after receiving a request for hearing, USDA must issue a timeline for actions that will result in completion of the hearing within 120 days OR request further information from petitioners to use in making a decision whether to hold a hearing OR deny the request.

- Post-hearing briefs must be filed within 60 days of the hearing.

- USDA must issue a recommended decision within 90 days of the deadline for filing post-hearing briefs.

- USDA must issue a final decision within 60 days of the deadline for receiving comments and exceptions to the recommended decision.

Note that the entire process for amending and order after receiving a proposal would still require at least one year under these "expedited" rules, and the process could be even longer if USDA requests further information from petitioners or allows a lengthy time for filing comments and exceptions to a recommended decision.

USDA is authorized to assess "the affected industry" as necessary to cover the costs of expedited rulemaking. USDA is also authorized to use informal rulemaking to amend those parts of orders that do not involve pricing provisions, for example pooling requirements.

A curious and somewhat confusing provision shows up in this section of the dairy subtitle. In any hearing considering adjustments to the make allowances used in federal order pricing formulas, USDA is required to calculate and consider prices of feed and fuel incurred by dairy farmers in the relevant marketing area. Make allowances are set in reference to the cost of manufacturing dairy products; they have no relationship to the cost of producing milk. We can only surmise that Congress is suggesting that processors should not be permitted to recover elevated fuel and energy costs if feed and fuel costs to

farmers increase, a suggestion that is not entirely logical and that could result in fewer dairy plants willing to accept milk.

Dairy Indemnity Program

The Dairy Indemnity Program (DIP), as authorized by the Agriculture, Rural Development, Food and Drug Administration and Related Agencies Appropriations Act of 1998, is extended through 2012. Under this program, USDA can reimburse dairy producers who have been directed by a public agency to remove their raw milk from the commercial market because it has been contaminated by pesticides and other chemical residues, nuclear radiation or fallout, or toxic substances. Dairy product manufacturers can only be reimbursed for dairy products removed from the market because of pesticide contamination.

Dairy Promotion and Research Program

The National Dairy Promotion and Research Board was authorized as part of the Dairy Production Stabilization Act of 1983 and the generic promotion program has operated essentially unchanged since then. Dairy producers are assessed 15¢/cwt of milk sold for commercial use, with the proceeds allocated between a national program operated by Dairy Management Incorporated (DMI) and qualified state programs. In Wisconsin, 10¢/cwt is allocated to the Wisconsin Milk Marketing Board (WMMB) and the remaining 5¢/cwt is allocated to DMI. In 2007, this assessment generated about $275 million in generic promotion and research funds nationwide and about $2.3 million for WMMB.

The 2008 Farm Bill extends the authority of USDA to collect assessments through 2012. The significant changes to the national program are in terms of the geographic coverage of the assessment and in the application of an assessment for imported dairy products.

In the 2002 Farm Bill, Congress extended the 15¢ assessment to cover the milk equivalent of imported dairy products. This was done in response to the vocal concerns of some dairy interest groups that imports were “free-riding” on the generic promotion efforts funded by the domestic producers. However, USDA did not implement the import assessment because it may have violated WTO rules. Specifically, Alaska, Hawaii, and Puerto Rico were exempt from the national assessment. USDA counsel argued that failure to collect the assessment on all milk produced domestically made it illegal to collect an assessment on imported dairy products.

To remove this obstacle, Congress eliminated the domestic exemptions. It also reduced the assessment on imported dairy products to 7.5¢/cwt milk equivalent.

Report on Department of Agriculture Reporting Procedures for Nonfat Dry Milk

USDA's Office of Inspector General (OIG) has estimated that between April 29, 2006, and April 14, 2007, the total value of milk marketed under the Federal Order system was understated by $50 million due to a misreporting of nonfat dry milk prices and quantities sold.[10] To allay fears of further problems with respect to the accuracy of reported nonfat dry sales, the 2008 Farm Bill requires that within 90 days of enactment, the Secretary of Agriculture submit to the House Agriculture Committee and the Senate Committee on Agriculture, Nutrition and Forestry a report outlining previous and current reporting procedures for nonfat dry milk. In addition, the Secretary is instructed to provide an assessment of the impact of these procedures on Federal Order minimum prices for the period July 1, 2006, through May 22, 2008. This assessment will augment the analysis already conducted by OIG.

Federal Milk Marketing Order Review Commission

The dairy subtitles of most recent farm bills have included requests for USDA to conduct studies on certain matters related to milk pricing. The 2008 Act goes a step further in establishing an independent commission to conduct a "…comprehensive review and evaluation of (1) the Federal milk marketing order system… and (2) non-Federal milk marketing order systems."

The Commission is charged with considering legislative and regulatory options for ensuring and enhancing the future competitiveness of dairy products, both in the U.S. and abroad, ensuring transparency in dairy pricing, and simplifying the federal order system, including streamlining and expediting order amendments. The Commission is also asked to evaluate whether the Federal milk order system serves the interests of producers, processors, and consumers and to study the costs and benefits of adjusting milk composition standards (i.e., adopt higher nonfat solids standards in fluid milk).

The Commission will consist of 14 members. Membership must include 4 dairy producers, four dairy processors, one retail representative, one representative of a national consumer organization, and 4 representatives from land grant universities that have accredited dairy economics programs, two of whom must be experts in the field of economics.[11]

The Commission is required to submit a report to Congress and the Secretary of Agriculture within two years after the date of its first meeting.

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[10] Office of Inspector General, 2008. Survey and Estimation Internal Controls for Nonfat Dry Milk and the Dairy Products Prices Report, Report No. 26901-01-IR, Washington D.C., February. A copy of this report can be found at: http://future.aae.wisc.edu/pubs/pubs/show/326 .

[11] We are not aware of any accreditation process for dairy economics programs at land grant universities, but we are hopeful that the dairy economics program at UW-Madison is accredited by whatever body does this.

Mandatory Reporting of Dairy Product Inventories

The 2008 Farm Bill strengthens mandatory reporting of dairy-related sales and inventory information by providing authority for the Secretary of Agriculture to establish an electronic reporting system (subject to the availability of funds) and to increase the frequency of reporting once the electronic reporting system is in place. The new bill also requires the Secretary to conduct quarterly audits of information submitted and to compare this information with "related dairy market statistics."

Summary

For dairy, the 2008 Farm Bill involves treading water. Changes in dairy programs are fewer and certainly less significant than those made in previous farm bills dating back to the early 1970s. There is no dairy termination program, no whole herd buyout, no mandated federal order reform, no scheduled elimination of the milk support program and no new direct payment program.

For the most part, the changes made represent small improvements. The change from supporting milk prices to supporting the prices of specified dairy products could potentially benefit dairy interests in future trade negotiations. The previous method of calculating dairy's cost in the form of trade distortion was absurd. Linking the target price under the MILC program to feed costs is a clear improvement in the sense of making the program more countercyclical in nature. Permanently allowing dairy plants to offer forward price contracts without running the risk of violating federal order rules was a very positive step, as was forcing USDA to make federal order amendment decisions before the reason for the amendment was irrelevant or forgotten.

On the negative side, we question the rationale for extending DEIP export subsidies. U.S. dairy export growth over the last three years has been very impressive. Our dairy companies have gained valuable export experience. World dairy markets are expected to grow with global economic growth. Clinging to export subsidies is anachronistic and a mistaken tacit admission that we are unwilling or unable to compete globally.

We also wonder if the lengthy political maneuvering to ensure that dairy imports are assessed under the National Dairy Promotion and Research program is worth the effort or, possibly, counterproductive. In 2007, our dairy trade balance measured in value was positive. We have exported more milk solids than we have imported for many years. Assessing imports risks being assessed on exports. Retaliation could also come in the form of importers creating coalitions to become "qualified" promotion boards to use part of the assessment proceeds for advertising their products in the United States.

All-in-all, an unremarkable dairy subtitle, which is probably a good thing for a change.