

2008 Farm Bill

Dairy Provisions

The Food, Conservation, and Energy Act of 2008 contains several provisions that are important to dairy producers and processors:

- Milk Income Loss Contract program (MILC).
- Revisions to the Dairy Product Price Support program (DPPSP).
- Dairy Forward Pricing program renewal.
- Dairy Export Incentive program (DEIP) extension.
- Dairy Indemnity.
- Federal Milk Market Order amendment procedures revisions.
- Mandatory dairy sales and inventory reporting established in previous dairy title strengthened.
- Dairy Promotion and Research program.

Milk Income Loss Contract (MILC)

The reauthorized MILC is similar to the previous MILC and MILC-X programs. However, a formula was added to adjust the target price for feed costs. The objective of MILC is to make price deficiency payments to eligible dairy operators.

Maximum covered milk production per farm is set at 2,985,000 million pounds, an increase of 585,000 pounds from the previous limit. Based on average 2007 Iowa milk production per cow, this would be equivalent to a herd of 147 cows. An estimated 87 percent of U.S. dairy farms would have their entire milk production covered. The higher limit added full coverage for an additional 2,890 farms. Brian Gould, University of Wisconsin-Madison dairy economist, estimates that 44 percent of U.S. milk production could be covered by MILC now.

Another revision to MILC is an increase in the covered difference between the \$16.94 base price and the class 1 Boston price. The new coverage is 45 percent of the difference instead of 34 percent for MILC-X.

A new provision in MILC is the Feed Cost Adjuster to the base price. The base feed cost is set at \$7.35 per hundredweight. At the end of each

month USDA will calculate that month's cost of feed. The ration is assumed to include 51 percent corn, 41 percent alfalfa hay and 8 percent soybeans. Prices used to calculate the "National Average Dairy Feed Cost" are those reported in USDA's Agricultural Prices publication.

At the end of each month, USDA will calculate the National Average Dairy Feed Cost. If the feed cost is calculated to be less than \$7.35, the base milk price will be \$16.94. If the feed cost is higher than \$7.35 per cwt., the percentage increase above the base is multiplied by 0.45. The \$16.94 base price is then increased by this value.

Example Calculation:

- a. Based on May 2008 data (Source: USDA's Agricultural Prices)
- b. Feed costs assumed:
 - Corn (\$/bu): \$5.12 per bushel x 1.79 cwt. per bushel x 51% = \$4.66
 - Alfalfa (\$/ton): \$177.00 per ton x .05 cwt. per ton x 41% = \$3.63
 - Soybeans (\$/bu): \$12.30 per bushel x 1.67 cwt. per bu. = \$1.64
- c. Total dairy ration cost is \$9.93 per cwt.
- d. Percent difference over base = $(\$9.93 - \$7.35) / \$7.35 = 35.12\%$
- e. MILC target adjuster = $35.12\% * 0.45 = 15.8\%$
- f. New MILC Price Target = $1.158 * \$16.94 = \19.62 per cwt.
- g. May Class I Boston price: \$16.62 (May Class I mover) + \$3.25 (Boston differential) = \$19.87 per cwt.
- h. The target price is below the Class I Boston price, so no MILC payment is made.

Using this feed cost adjuster would not have increased the MILC payment milk price from March 07 to April 08. As of May 23, 2008, Brian Gould projected MILC payments for July 2008 through May 2009, using CBOT and CME futures prices. None of the projected prices were lower than the target MILC price, meaning no MILC payment would

MILC Program Comparison

Characteristic	Value
Base Class I Target @ Boston (\$/cwt)	16.94
Class I Payment Rate (%)	
Oct. 1, 2007 – Sept. 30, 2008	34
Oct. 1, 2008 – Aug. 31, 2012	45
After Aug. 31, 2012	34
National Average Dairy Feed Cost (\$/cwt)	
Jan. 1, 2008 – Aug. 31, 2012	7.35
After Aug. 31, 2012	9.50
Feed Cost Adjustment Rate (%)	45
Annual Payment Quantity Limit (1,000 lbs)	
Oct. 1, 2007 – Sept. 30, 2008	2,400
Oct. 1, 2008 – Aug. 31, 2012	2,985
After Aug. 31, 2012	2,400

be expected. Those projections used much higher feed costs than are currently being paid. The feed cost adjuster has added another layer of uncertainty in projecting possible MILC payments.

Dairy producers must sign up for each year they wish to participate in MILC. Additionally, producers that expect to produce more milk than the annual payment quantity limit must choose those months in which they want to receive payments. For Iowa dairy herds of approximately 147 cows or less, all of their milk production will qualify for possible MILC payments. Larger herd owners will need to determine which months might receive the largest MILC payments and sign up to participate in those. Once producers are signed up for participation they may not opt out until the next fiscal year.

Dairy Export Incentive Program (DEIP)

DEIP was first authorized in the 1985 farm bill. DEIP was designed to promote exports of U.S. manufactured dairy product, allow faster international trade, and remove surplus dairy products during periods of excess production. DEIP has been reauthorized in all farm bills since 1985. The new authority is extended through December 31, 2012.

Products eligible for DEIP are milk powders, butter, butter fats, and several cheese varieties. DEIP sales are made by private U.S. firms. After arranging a potential sale, the dairy product exporter submits a bid to USDA requesting a DEIP bonus payment to bring the importer's cost to world market price. This bonus then allows the U.S. dairy product to be price competitive.

DEIP was used to subsidize nonfat dry milk exports during the 1990s when world prices were lower than in the U.S. U.S. dry milk prices have dropped to levels equal to or lower than world prices in the last 5 years, leading to increased exports without extensive DEIP bonuses. Also, Oceania, a primary milk powder exporter, has been suffering from production difficulties due to drought.

Dairy Product Price Support Program (DPPSP)

The 2008 Farm Bill redefined the way USDA's Commodity Credit Corporation (CCC) will support milk prices. Rather than directly support Class III prices, the CCC will purchase dairy products at specific prices:

- Cheddar cheese blocks: \$1.13
- Barrels: \$1.10
- Butter: \$1.05
- Non-fat Dry Milk (NFDM): \$0.08

The 2008 farm bill authorizes the Secretary of Agriculture to operate this program from January 1, 2008 to December 31, 2012.

The move to purchasing dairy products at fixed prices no longer supports a specific manufacturing milk price. It also avoids the butter versus powder tilt issues. Under the previous milk price support program, when butter purchase prices were reduced, NFDM purchase prices had to be raised in order to maintain a specific manufacturing milk price.

The 2008 farm bill also allows the Secretary to reduce support prices if CCC purchases become too large over a 12-month period. See table 1 for the trigger amounts and prices.

Table 1. Dairy Product Price Support Program, Price Cut Triggers

Product	12-Month Net Removal Triggers	Maximum Per Lb. Decrease
Cheddar Cheese	> 200 mil. lbs and < 400 mil. lbs	10¢
	> 400 mil. lbs	20¢
Butter	> 450 mil. lbs and < 650 mil. lbs	10¢
	> 650 mil. lbs	20¢
Nonfat Dry Milk	> 600 mil. lbs and < 800 mil. lbs	5¢
	> 800 mil. lbs	10¢

An objective of the restructuring in milk price supports is to reduce dairy's contribution to Aggregate Market Support (AMS). The U.S. no longer supports a specific milk price to be received by dairy farmers. During 2007, the World Trade Organization (WTO) calculation was that dairy production contributes 25 percent to the limit allowed for U.S. agriculture support. Even though no surplus dairy products have been purchased since 2004, WTO still scores dairy as if it receives a major price subsidy. The change to supporting dairy product prices is an attempt to avoid WTO problems. The initial milk product prices set are calculated to achieve a \$9.90 per cwt. manufacturing milk price, the same as the milk support price in the previous farm bill.

At current milk prices and production levels, CCC surplus dairy products are highly unlikely. Also, the probability of reaching surplus dairy product purchase levels high enough to trigger product price reductions is relatively small. Since 1990 net removals of cheddar have never exceeded 200 million pounds, the trigger for price reduction. And since 2004, no cheese has been purchased under the milk price support program. NFDM net removals did reach levels that would have triggered a 5-cent price reduction in 2000 and 2002, and a 10-cent price reduction in 2003. However, since 2005, no NFDM has been purchased under the price support program. Since 1990 butter purchases have never hit the price reduction trigger.

Dairy Forward Pricing Program

The 1999-2004 Forward Pricing Program (FPP) has been reauthorized in the 2008 farm bill. The FPP allows all non-cooperative milk buyers to contract Class III milk prices paid to dairy producers and cooperatives. The program applies only to milk marketed in Federal Milk Market Orders (FMMO).

FMMO regulations require non-cooperative milk buyers to pay the FMMO minimum prices even though contracts are in force. This regulation has prevented cooperatives from contracting with their buyers as well. Cooperative milk buyers are exempt from this regulation when purchasing milk from their dairy producer members and have been able to offer Class III contracts.

Milk handlers may not require forward contracts as a condition of receiving milk, either from a dairy producer or a dairy cooperative. Contracts may be entered into until September 30, 2012. The contracts may run until September 30, 2015. The Secretary of Agriculture must investigate complaints of coercion to enter into forward price contracts.

Summary

For dairy producers and processors, the 2008 farm bill is mainly a continuation of previous policy. No major dairy farm policy changes have been enacted since the initial authorization of MILC. Only minor changes or modifications were enacted in the 2008

farm bill. The addition of the feed cost adjuster to the MILC program brings it closer to a counter cyclical gross margin program. The dairy subtitle of the 2008 farm bill was not a source of political controversy nor did it hold up passage of the bill, unlike in 1996 and 2002.

Reference: "Dairy Subtitle: Food, Conservation, and Energy Act of 2008," Marketing and Policy Briefing Paper No.94, June 2008. Ed Jesse, Bob Cropp, and Brian Gould, Department of Agriculture and Applied Economics, College of Agriculture and Life Sciences, University of Wisconsin-Madison.

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Prepared by Robert Tigner,
extension farm
management specialist
641-394-2174
rtigner@iastate.edu

www.extension.iastate.edu/agdm
www.extension.iastate.edu/store
