HOUSE COMMITTEE ON AGRICULTURE — DEMOCRATS

Detailed Summary: Proposed Dairy Reforms

The devastation experienced by the dairy industry in 2009 made it clear that the current dairy safety net is inadequate and needs significant reform. The industry has since developed a package of necessary reforms in an effort to ensure that we continue to have a safe and abundant supply of fresh milk in the United States. This proposal is the basis for discussion draft legislation. The proposed reforms save taxpayer dollars, offer producers protection, create stability and inspire growth.

Replacing Current Programs

The Dairy Product Price Support Program (DPPSP) was developed in 1949 to encourage milk production in the United States. It allows the government to purchase dairy products off the market and store them for future sale or use. However, the dairy industry looked drastically different in 1949 than it does today.

Today, the export market is a major driver of demand growth for U.S. dairy products and a key component of stronger milk prices. In this environment, interrupting the flow of U.S. dairy products to export markets by temporarily diverting those products to the government is detrimental to maintaining export markets.

The Milk Income Loss Contract Program (MILC) compensates dairy producers when domestic milk prices fall below a specified level. Today, the program pays producers 45 percent of the difference between the actual Class I base price and $16.94, as adjusted by the dairy feed ration adjustment, and covers only 2.9 million pounds of a producer's milk per fiscal year.

After September 1, 2012, however, MILC will only cover 34 percent of the difference between Class I base price and $16.94. The volume of milk covered per producer, per year, will drop to 2.4 million pounds and the support from the feed ration adjustment will be reduced.

As witnessed in 2009, when prices are high but margins are low MILC does not provide an adequate safety net to producers. With increasing feed costs and shrinking margins, producers need a stronger safety net than these current programs can provide.

Proposed Reforms

Margin Protection Program

The margin protection program would provide a floor for producer margins by providing a government funded catastrophic loss safety net for all producers. In addition, the program would establish a supplemental margin program under which producers may purchase additional coverage.

The margin program would calculate a producer's margin based on the difference between the all-milk price and the average feed cost. USDA's National Agricultural Statistics Service (NASS) would report the all-milk price, and the average feed cost would be calculated based upon NASS's reporting price of corn and alfalfa and the Agricultural Marketing Service's reporting of the price of soybean meal. The program would be run through the Farm Service Agency, like the current MILC program.

Each participating producer will have an historical milk base – the highest annual milk production from the three years prior to implementation. This milk base will be fixed for the duration of the bill.

The margin program would be made available to new producers during the life of the bill, providing producers with a degree of margin protection they have not received in the past.

Dairy Market Stabilization Program

The Dairy Market Stabilization Program (DMSP) would help prevent extreme margin volatility for dairy producers by sending producers strong and timely market signals that do not currently exist. Those signals alert producers when additional milk production entering the market may have significant consequences on their overall margins. This program also takes into account export markets, allowing the industry to continue meeting increased worldwide demand. The DMSP is designed to act swiftly and infrequently to address brief market imbalances.

- When the actual national margin is below $6.00 for two consecutive months, producers will receive payment for 98% of their base milk marketings and be subject to a maximum reduction in payment equal of 6% of current milk marketings.

- When the actual national margin is below $5.00 for two consecutive months, producers will receive payment for 97% of their base milk marketings and be subject to a maximum reduction in payment equal of 7% of current milk marketings.

- When the actual national margin goes below $4.00 in a single month, producers will receive payment for 96% of their base milk marketings subject to a maximum reduction in payment equal of 8% of current milk marketings.

USDA would be authorized to periodically conduct audits to ensure compliance with the program.

Under the proposal, a producer board will be appointed by the Secretary of Agriculture with the authority to purchase products through commercial sources for donation to food banks and other appropriate sources, as well as to conduct other activities that expand consumption and build demand for dairy products without duplicating activities by the dairy check-off.

Reforming Federal Milk Marketing Orders

The Federal Milk Marketing Orders provide substantial benefits to dairy farmers and milk processors by ensuring the equitable sharing of revenues generated by bottled milk sales, providing milk market information and auditing how milk is used in plants to ensure a level playing field among processors. However, in today's global marketplace it is too cumbersome and complex, stymies product innovation, and results in unintended consequences.

The reform proposal simplifies the basic system. Currently there are four price categories, or classes, of milk, based on the end product – Class I is for bottled milk, Class II is for products like ice cream, yogurt and cottage cheese, Class III is for cheese and Class IV is for butter and nonfat dry milk powder. The proposal would reduce the number of classes from four to two. Class I would remain as bottled or fluid milk and Class II would be milk that is processed or manufactured into other dairy products.

The reform proposal would also eliminate the complicated end-product pricing formulas to determine minimum milk prices for the different classes of milk. The make allowances and yield factors built into these price formulas have become a major source of debate and division within the dairy producer and processor communities. Critics maintain that end-product pricing creates winners and losers in the marketplace and that requiring a minimum price puts dairy product manufacturers at a competitive disadvantage with areas not regulated by federal orders.

The proposal would move dairy pricing to a more market-oriented competitive pricing structure. The proposed reforms replace end-product pricing formulas and mandated minimum prices with a competitive milk pricing system. Dairy product manufacturers will compete for a milk supply. A competitive price not only fairly compensates producers based on local supply and demand; it also reduces price volatility, encourages product innovation and allows manufacturers to compete domestically and internationally.

Summary

If enacted, this proposal will provide a more effective, yet lower cost, safety net for dairy producers, a simplified milk marketing system for processors and an abundant and safe food supply for consumers.