



1 **4-Sep-10**

2
3 **The Availability and Use of Existing Laws and Programs to Improve**
4 **Dairy Sector Economics**

5
6 **Dairy Industry Advisory Committee**

7 **U.S. Department of Agriculture**

8 **October 2010**

9
10 **Forward**

11 The United States Department of Agriculture (USDA) established the
12 Dairy Industry Advisory Committee in August 2009, under the rules of the
13 Federal Advisory Committee Act (FACA). Agriculture Secretary Tom Vilsack
14 announced the appointment of 17 members to serve on the Dairy Industry
15 Advisory Committee on 6 January 2010.

16 As stated in its Charter, the purpose of the Committee is to review the
17 issues of: 1) farm milk price volatility and 2) dairy farmer profitability. The
18 Committee will also provide suggestions and ideas to the Secretary on how
19 USDA can best address these issues to meet the dairy industry's needs.

20 This Committee is in the public's interest in view of the dairy industry's
21 importance to the nation's economy. The exchange of views and information
22 between industry representatives and USDA should result in improved
23 understanding of the impact of USDA programs on the dairy industry and
24 contribute to those programs' effective and efficient administration.



US Department of Agriculture
Dairy Industry Advisory Committee

Subcommittee A
Final Report

1 The members of the Committee are as follows. All members except Dr.
2 Novakovic are considered under FACA to be serving as Representatives
3 Members are appointed to obtain the points of view of or perspectives of
4 outside interest groups or stakeholders for whom they represent. Dr.
5 Novakovic serves as a Special Government Employee under appointment by
6 Secretary Vilsack. An SGE is appointed to provide unbiased and independent
7 advice. SGEs assume the responsibilities, obligations, and restrictions that
8 are part of public service.

9

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**US Department of Agriculture
Dairy Industry Advisory Committee**

Subcommittee A
Final Report

Members	Affiliation	Committee Assignment
Paul Bourbeau	Paboco Farms, Inc., Vermont	Subcommittee Chair - Current Programs
Jay Bryant	Maryland and Virginia Milk Producers Cooperative Association, Virginia	Subcommittee Chair - Volatility
Erick Coolidge	Le-MA-Ra Farm, Pennsylvania	Vice Chair Subcommittee Chair - Profitability
Timothy Den Dulk	Den Dulk Dairy Farm, LLC, Michigan	Member
Debora Erb	Springvale Farms & Landaff Creamery, LLC, New Hampshire	Member
James Goodman	Northwood Farm, Wisconsin	Member
James Krahn	Oregon Dairy Farmers Association, Oregon	Scribe
Edward Maltby	Northeast Organic Dairy Producers Alliance, Massachusetts	Scribe
Rodney Nilsestuen (Dec. July 2010) replaced by Randy Romanski	Department of Agriculture, Trade and Consumer Protection, Wisconsin	Member
Andrew Novakovic	Cornell University, New York	Chair Chief Scribe
Robert Schupper	Giant Food Stores, Pennsylvania	Member
Manuel (Ray) Souza	Mel-Delin Dairy, California	Member
Patricia Stroup	Nestle USA, California	Member
Sue Taylor	Leprino Foods Company, Inc., Colorado	Scribe
Edward Welch	Associated Milk Producers Inc., Minnesota	Member
James (Ricky) Williams	Williams Dairy & Williams Dairy Trucking, Inc., Georgia	Member
Robert Wills	Cedar Grove Cheese Inc., Wisconsin	Member



1 **Executive Summary**

2 {needless to say, this section will be short and pithy, perhaps little more
3 than a page will be required for this report. In any case, I didn't think it
4 made sense to draft this section until agreement was reached on the body of
5 the report. AN}

6

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1 **Introduction**

2 With the ink barely dry on the 2008 Farm Bill, the US economy plunged
3 into what has been arguably the worst recession since the Great Depression
4 of the 1930s. The dairy sector did not suffer alone in the 2009, but it had
5 more than its share of the challenges and hardship. It plunged into the
6 Great Recession from a period of prosperity not matched since the late
7 1970s. The fall from this lofty position involved recession-driven demand
8 effects and more sector specific supply effects. Exports, which had been a
9 primary cause of the lift in 2007 and 2008, collapsed as global demand
10 withered. Domestic demand, especially in foodservice, withered as
11 consumers trimmed household budgets. On the supply side, the costs of the
12 single largest input into milk production – feed – hit record highs. This in
13 turn created the worst price:cost squeeze since the early 1970s. Poised for
14 a cyclical downturn in any event, the Great Recession in combination with
15 record grain prices pushed virtually every dairy farm business into the red
16 and eliminated years if not decades of growth in dairy farm balance sheets.

17 Although the Dairy Product Price Support Program eventually kicked in
18 at the bottom of the price trough in early 2009, the level of support
19 provided was far less than required to ensure even breakeven cash returns
20 for dairy farm businesses. The Milk Income Loss Contract program provided
21 much needed cash supplements to many farmers, but the marketings-based
22 limit on payments meant that any farm larger than 110-150 cows, a little
23 more than the national average, received a supplement on only a portion of
24 their milk. This limitation applied to about 15% of the farms, which produce
25 75% of the nation's milk. For the 2.5% of the largest farms, which produce



1 47% of the milk, the amount received was a small to trivial percentage of
2 their total gross income. The negative economic effects during 2009 were
3 certainly no less or easier for larger farms, and arguably worse to the extent
4 they rely more heavily on purchased feeds.

5 Although the current net income situation for dairy farmers is much
6 improved in 2010, the milk production sector has not restored its balance
7 sheet and feels very vulnerable in the current uncertain economic
8 environment.

9 The purpose of this report is to catalog the various laws and programs
10 that presently exist to the economic benefit of dairy farmers and to discuss
11 their potential application and limitations in the recent and current market
12 environment.

13 **The Dairy Problem**

14 Milk Price Volatility

15 Prior to the establishment of permanent authority for the Dairy Price
16 Support Program under the Agricultural Act of 1949, farm milk prices
17 exhibited a high degree of instability, but these fluctuations were primarily
18 seasonal and generally predictable. From 1950 to 1989, milk price
19 instability was considerably dampened compared to the first half of the 20th
20 Century, in the range of half.¹ During the 1970s, the primary price mover

¹ The Coefficient of Variation – which measures dispersion or range adjusted by mean or average values, was 0.33 from 1942 to 1989 but only half that amount, 0.16, from 1990 to 2010. Volatility (as measured by the statistic historic volatility) was twice as large in the recent period – 16.3% versus 7.9%. In other words, adjusting for inflation, the general range in which prices move is actually less now



1 was inflation, which affected the entire US economy. From 1981 to 1990,
2 dairy economics was largely defined by huge surpluses engendered by an
3 overly aggressive price support policy in the late 1970s, followed by a
4 variety of policy interventions aimed at minimizing the need of reductions in
5 the price of milk. Ultimately, the support price for milk was reduced from
6 over \$13 per hundredweight (cwt) to around \$10 per cwt. Government
7 support under the price that buyers pay farmers for milk has remained
8 pegged at this level ever since. This level of support has proved to be
9 sufficiently low, so as to seldom affect the price of milk that is otherwise
10 market determined.

11 Since 1990, the farm milk price has become highly variable and
12 unpredictable. This combination of instability and uncertainty may be
13 described as price volatility.² The causes of this increased volatility are

than in the years of an active price support program but the volatility of market prices is considerably larger.

² To describe different aspects of pricing concerns, Andrew Novakovic of Cornell University differentiates three fundamental characteristics of a price series – 1) certainty/uncertainty, 2) stability/instability, and 3) adequacy/inadequacy.

Certainty might be defined as existing when a price can be predicted within a narrow range over an intermediate term. Dr. Novakovic does not propose a specific measure, but an example of certainty might be a monthly price that can be predicted within 5% over a one year period.

A currently stable price is not necessarily predictable in the future, and unstable prices are not necessarily unpredictable. A familiar dairy example would be the highly predictable seasonal patterns in milk prices common in the 20th Century.

Instability implies a frequency of change more than an amount of change (amplitude), thus, standard deviation or similar measures of dispersion are not



1 debatable. It would seem inarguable that the reduction of the federal
2 support price for milk had an enormous effect; however, to the extent this is
3 true, it did not create volatility so much as allow an underlying volatility or
4 susceptibility to volatility to be revealed. Dairy analysts have long described
5 dairy markets as having highly inelastic supply of and demand for farm level
6 milk, and demands for dairy products down the value chain. While the
7 degree of elasticity is sometimes debated, most industry members would
8 agree that the short term elasticities are indeed small. As such, small
9 relative changes in quantities are associated with large relative changes in
10 price. This would certainly be consistent with the post 1990 experience.

11 While this is likely an important element of the story, it begs the
12 question why have supply and/or demand changed sufficiently over the last
13 20 years to result in the large price swings that have been observed. Figure

reliable measures of standard deviation. Log relative volatility or historic volatility, statistics used primarily in the finance literature, are better measures of instability.

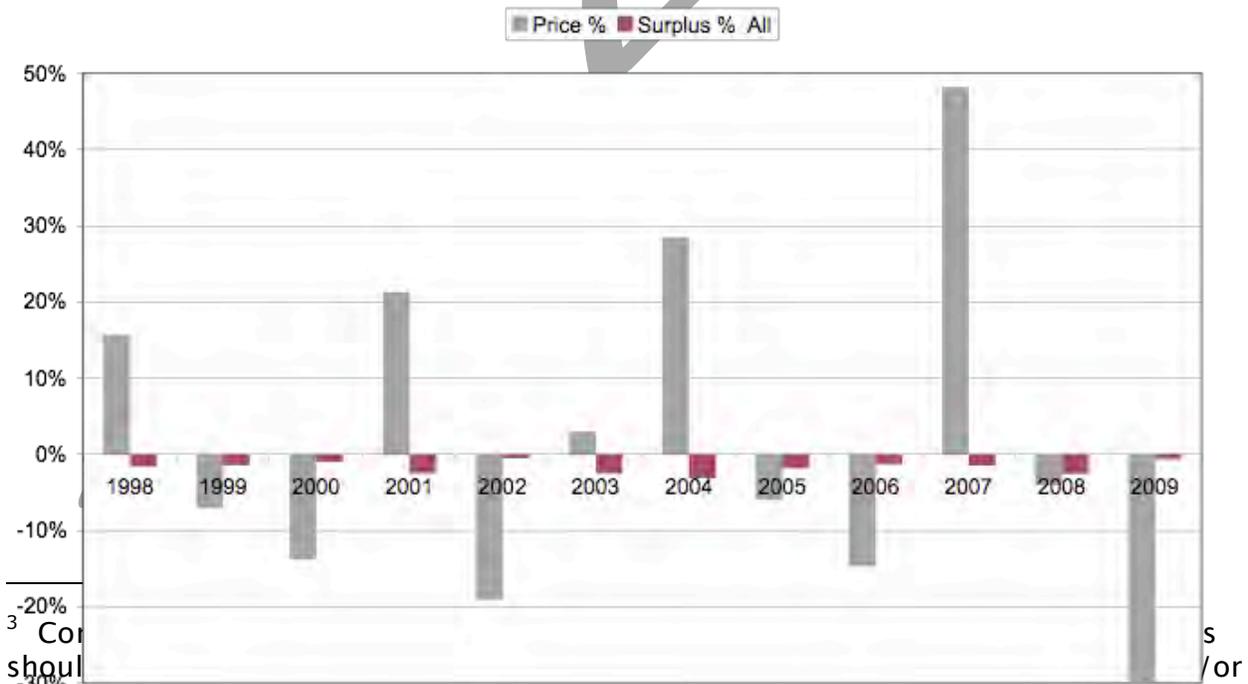
Adequacy refers to the degree to which a price is associated with positive financial outcomes for a business whose output receives that price. A number of measures might plausibly appeal to a business owner's concept of adequacy. Certainly profitability would be a desirable long term measure. However, other measures might also be applied, including return on assets, return on equity, return on investment, net returns over cash cost or cash flow from operations, cash flow coverage, and so on. A number of policy advocates have endorsed net returns from the sale of milk in excess of the cost of feed as a convenient and meaningful measure of adequacy.

The term volatility has been much used in the recent economic context and seems intended to convey something more or different from instability. Dr. Novakovic's proposed nomenclature uses the term volatility to describe a price that is characterized by both instability and uncertainty and is inadequate at its lower points.



1 1 compares annual percentage changes in the average US price of all milk
2 (at average composition) and the difference between milk production and
3 commercial disappearance (as measured on a milkfat equivalent basis). The
4 latter is a crude measure of domestic surplus (or deficit).³ During the
5 inflationary period that begin in about 1972, unusually large annual
6 increases in price were generally associated with modest levels of domestic
7 surplus. However, these modest surpluses burgeoned into oppressively
8 large surpluses by the early 1980s. During that decade, prices drifted
9 downward as the federal government made repeated and bold efforts to
10 avoid or reduce price cuts through a variety of supply controlling and

Comparison of Relative Change in Annual US All Milk Suplus with All Milk Price



³ Comparison should be made with the change in the price of milk. A negative value (deficit) means stocks were liquidated and/or imports shrunk. A positive value (surplus) means stocks were accumulated and/or imports grew.



1 demand enhancing actions. Ultimately, a 25% cut in the support price
2 occurred before markets settled into equilibrium.

3 The first few years following the collapse of the Dairy Price Support
4 Program witnessed the kind of turbulence that has now become familiar, but
5 these were interspersed with a few calmer years as well. The next
6 significant policy event that seems have forever changed dairy markets was
7 the conclusion of the Uruguay Round negotiations under the General
8 Agreement on Tariffs and Trade, now know by the acronym WTO, for the
9 new secretariat created after the Uruguay Round – the World Trade
10 Organization. In the US, the Uruguay Round Agreements Act was passed in
11 1994. Under the Agreement on Agriculture (AoA), the US agreed to roughly
12 double the access to its dairy markets by foreign competitors (about 2.5% to
13 5%) and replaced its strict import quota system with a tariff-based system
14 that generally provided a high degree of protection from most dairy
15 commodities and greater access to value added products (such as European
16 style cheeses). Since that time, the relationship between price changes and
17 degrees of domestic surpluses has changed dramatically. Although some of
18 the annual levels shown in Figure 1 are not unprecedented, the general
19 pattern is strikingly different from earlier years. Now domestic surpluses
20 (actually small deficits) come at the expense of huge relative swings in the
21 price of milk. While it is dangerous to infer too much from this simple
22 comparison, the graph paints a picture of markets that cannot afford to stray
23 too far from domestic balance but which require large and rapid changes in
24 price to accomplish that goal. With the US government no longer serving
25 effectively as the buyer, and inventory holder, of last resort, there is little



1 incentive for an individual firm to balance annual fluctuations in US supply
2 and demand by holding strategic or precautionary stocks.

3 This underlying change in dairy markets, combined with other
4 exogenous shocks, have resulted in dramatic swings in the price of milk.

5 Costs of Production

6 In addition to the large swings in the price of milk, dairy farmers have
7 experienced significant changes in underlying costs of production, driven by
8 dramatic changes in the prices of certain key inputs. The single largest
9 component (40-50%) of any dairy farmer's cost of production is the cost of
10 feed, whether it is in the form of purchased grains and other feed inputs or
11 as the costs of producing homegrown feeds. Thus, farmer's are especially
12 sensitive to the prices of purchased feeds or the prices of inputs used in
13 homegrown feed production. Key feedstuffs are corn, soybeans and alfalfa
14 hay. Key production inputs are fuel and fertilizer.

15 From Fall 2006 through Summer 2008, the price that growers received
16 for a bushel of corn increased from about \$2 to about \$5.50. Great news for
17 corn growers, this represented an enormous cost increase for dairy and
18 other livestock farmers. The increase in soybeans was equally dramatic.
19 Although it would be a bit too simplistic to attribute all of this effect to the
20 burgeoning demand for ethanol made from corn, it is undeniable that bio-
21 fuels created a large and new demand for corn and, to a much lesser extent,
22 soybeans. Petroleum prices began increasing out of the previous historic
23 range in 2002. The stimulus of high petroleum prices, increasing uncertainty
24 about the reliability of Middle Eastern sources of petroleum, and successful



1 efforts to create various federal incentives for corn-based ethanol
2 contributed to pushing corn prices to dramatic heights in 2007 and 2008.

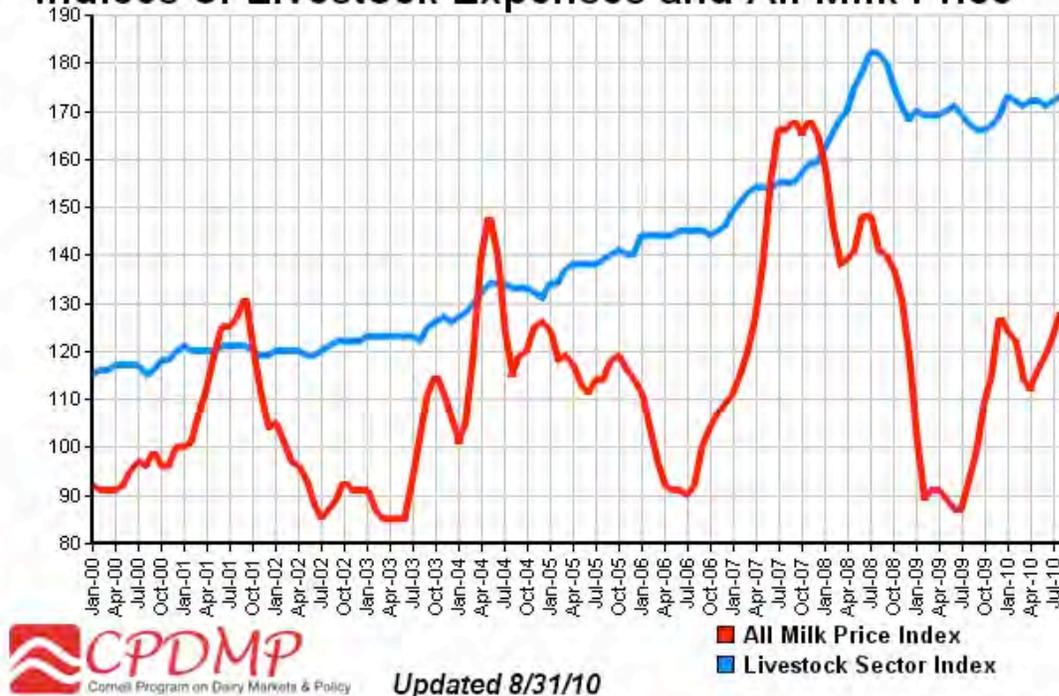
3 Milk prices had hit a cyclical low in 2006. In part due to an expected
4 cyclical rebound but with the added stimulus of high feed costs, the price of
5 milk moved from a low of \$11.70 per cwt in July 2006 to a high of \$21.90 in
6 November 2007 – the all time record high for the nominal price of milk. In
7 the early months of 2007, the rise in the price of milk did not keep pace with
8 increases in feed costs. Farmers experienced the curious but not
9 unprecedented phenomenon of relatively high milk prices but poor net
10 returns. By the peak of the market, farm returns were more than enough to
11 compensate for high feed prices and net returns were generous for a few
12 months.

13 By the end of 2008 and through 2009, the equation had again turned
14 against dairy farmers. Although corn prices and other input prices had
15 softened considerably from their previous highs, largely due to record crop
16 production, milk prices had fallen even more. The hard lesson of 2009 was
17 not so much the low price of milk, which after all was no lower than the
18 bottoms of the last two three-year cycles, but the unprecedented low to
19 negative margins. In many months, there was little if any left over from the
20 milk check to pay for more than the cost of feed. This is illustrated in Figure
21 2. This figure compares indices of the US price of all milk with USDA's index
22 of production inputs purchased by a weighted average of livestock
23 production. Dairy is only one part of this livestock index, but it is a sufficient
24 measure to illustrate the dramatically poor relationship between feed
25 weighted input prices and the price of milk. This chart illustrates vividly that



1 the dramatic outcome of 2009 was not how low the price of milk became,
2 per se, but rather the (perhaps unprecedented) narrowness between the
3 price of milk and the costs of inputs, especially feed inputs.

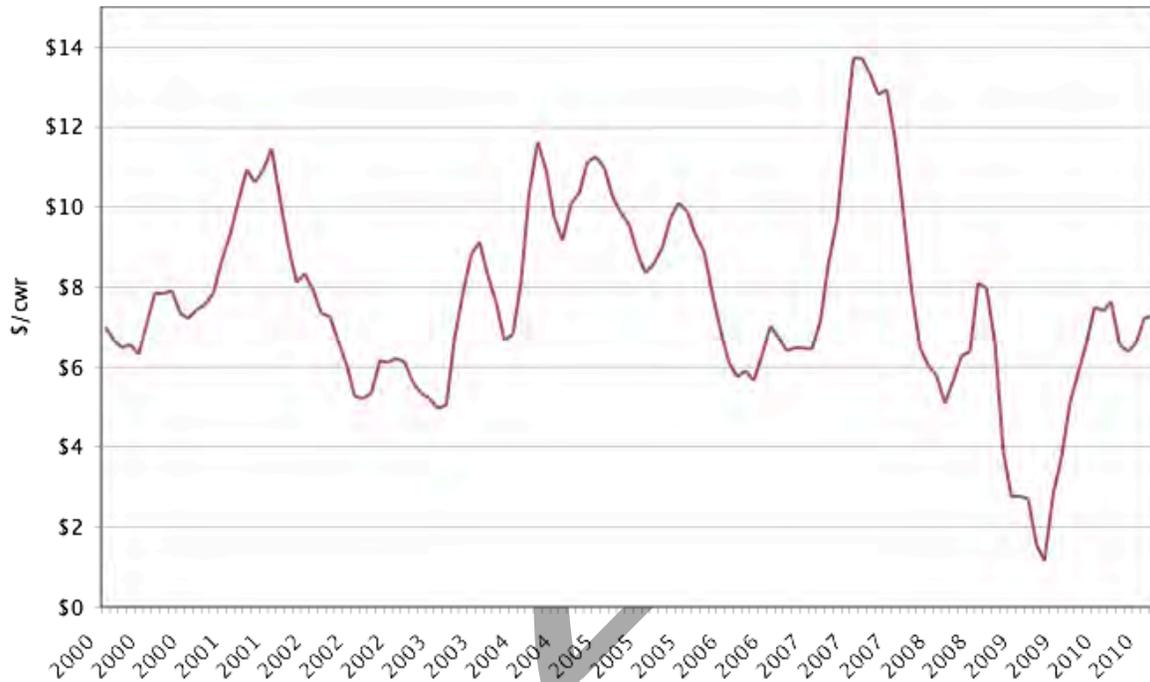
4 **Indices of Livestock Expenses and All Milk Price**



5 The previous chart shows prices. In the next chart, these prices are
6 translated to returns to milk above feed costs, using the methodology
7 developed by the National Milk Producers Federation, as described in their
8 proposal called Foundation for the Future. Although milk prices (in the
9 above chart are equally low in 2003-04, 2006, and 2009, in this next chart it
10 is vividly clear that the net returns to milk above the costs of the (major)
11 feeds is dramatically lower in 2009.



Milk Margin Over All Herd Feed Costs



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2

3 Trade Shocks

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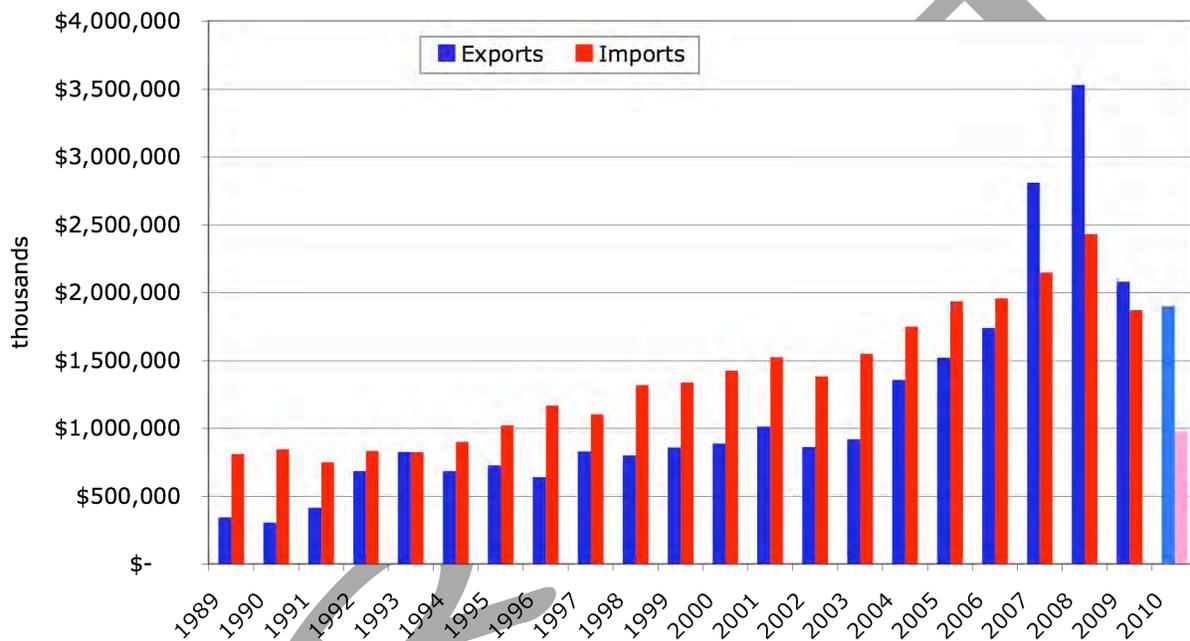
9

As mentioned above, the US dairy sector became considerably more exposed to trade following the Uruguay Round agreement. This resulted in both greater opportunities for exporting, as well as greater openness to imports. In the years that have followed the URAA, the US dairy sector has generally become a slight net importer of dairy products; however, it has demonstrated a capacity to increase exports considerably when conditions



1 are right. Such was precisely the case in 2007 and 2008, as illustrated in
2 the next chart.⁴

Total Dollar Value of US Dairy Imports and Exports,
1989 to July 2010



3

4 **Current Legislative and Regulatory Authorities**

⁴ Dairy trade can be measured in several ways. For individual products, quantity measures are fairly straightforward. For aggregations of products, the typically approach is to translate product pounds into a milk equivalent. While this seems easy enough in principle, in practice it becomes challenging because traded products have very different compositions of milkfat and nonfat solids. An alternative is to measure trade in dollar value. This has a certain appeal and finesses the problem of milk equivalents, but it introduces other consequences. Because the US tends to be an importer of high margin products and an exporter of low margin products, dollar measures tend to give greater weight to exports than quantity measures.



1 What is generally referred to as dairy policy or dairy programs are legal
2 authorizations or mandates specified by Congress and implemented as
3 regulations by the US Department of Agriculture or another executive
4 agency of the federal government. Some of these programs exist under
5 permanent law, in which the provisions have no sunset until Congress
6 explicitly changes them. Others are of a more temporary nature. They may
7 exist for many years, but periodically Congress needs to reaffirm them.

8 In addition, Congress has a good deal of latitude in how strongly it
9 directs an action of the Executive Branch. In many cases, a law authorizes
10 USDA or another agency to do something, but it does not require or even
11 enable that action. For example, under the old parity-based Dairy Price
12 Support Program, the Secretary of Agriculture could announce a support
13 price for milk that was no less than 75% of the parity price but no more than
14 90%. Thus, he was authorized or allowed to choose within a broad range.
15 Sometimes, the Secretary is allowed to decide whether to do something at
16 all. For example, the Secretary is not required to implement a Federal Milk
17 Marketing Order either by the instruction of Congress or at the request of
18 farmers. The Secretary has the authority to deny a request for a new Order
19 (although such a decision could be challenged by a court action). Lastly, the
20 Secretary may be authorized to do something, and it may in fact be
21 something that Congress or the Secretary would really like to do, but
22 Congress or the Executive did not provide for funding to actually do the act.
23 An example of this would be the authorization in the 2008 Farm Bill that
24 USDA initiate electronic reports of market dairy prices based on prices that
25 firms would be required to disclose to USDA. Congress did not provide



1 specific funding for this costly project and USDA determined it lacked the
2 flexibility to reassign existing general funding to support this new activity, so
3 there was no new electronic reporting.

4 In this section, we will describe programs that currently exist which
5 could be used to have direct effects on milk prices, dairy product sales, farm
6 incomes, or some other direct aspect of dairy markets. Needless to say,
7 there are a huge number of federal programs that affect dairy markets,
8 including tax policy, public borrowing and other enormous macroeconomic
9 programs as well as things like highway transportation, fuel taxes,
10 environmental regulations and other such items that have implications for
11 the dairy sector but which are clearly not dairy programs per se. The focus
12 here will be on programs that are clearly dairy programs or which could have
13 a clear and substantial impact on dairy markets without requiring an
14 implausible focus on dairy from a program whose purpose is much broader.

15 The Dairy Product Price Support Program

Summary of Dairy Product Price Support Program (DPPSP)

Objectives:

- Price Support - prevent farm price of milk from falling below a minimum target level
 - Farm price stability
 - Farm income enhancement
- Market security
- Prevent wholesale price of selected dairy commodities from falling below a minimum target level
 - Price stability for selected dairy commodities
- Maximal effect on protecting against price decreases, minimal effect on inhibiting price increases
- Minimize impact on commercial sales when disposing of government stocks



Summary of Dairy Product Price Support Program (DPPSP)

Methods:

Under Dairy Price Support Program (DPSP) -

Law establishes a price support goal (minimum) for milk used to make manufactured dairy products. USDA estimates purchase prices for selected dairy commodities in bulk form that are consistent with that goal.

Under the Dairy Product Price Support Program (DPPSP) -

Law establishes purchase prices

Under both DPSP and DPPSP -

USDA/CCC offers to purchase butter, cheese, and nonfat dry milk, according to established specifications, at the announced purchase prices.

If this price is appealing to manufacturers of those commodities, compared to prevailing or expected market prices, the manufacturer initiates a "response" to USDA's "invitation."

CCC takes ownership of the product and is expected to dispose of the product in a manner that recognizes its value as a food product but which does not undermine the commercial market for similar products. This may include domestic and international food assistance, use in government programs and facilities, use in animal feeds, and the like.

If a product is offered for sale in commercial channels, it is at a price no lower than the established Sellback Price. Before 2008, the Sellback Prices were set by the Secretary and varied from 105% to 110% of the corresponding Purchase Price. Under FCEA 2008, the Sellback Prices are legislatively established at 110%

Legal Authority:

Agricultural Act of 1949 (as amended)

Administering Agency:

U.S. Department of Agriculture - Farm Services Agency

Farm Programs - Price Support Division

Commodity Operations - Commodity Credit Corporation

1 The Agricultural Act of 1949 created permanent authority for a Dairy
2 Price Support Program, under which Congress specified goals for the
3 minimum support of the price of milk received by farmers and USDA
4 implemented that goal by offering to buy selected bulk dairy commodities at
5 wholesale prices that were consistent with the farm price goal. This
6 approach to supporting farm milk prices was first developed as a trial
7 proposed by Land O'Lakes and financed by the federal government in
8 January 1930. Several subsequent federally financed purchases occurred in



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1 the 1930s and it was at that time that the parity price concept was
2 developed and fleshed out. During World War II, milk prices were supported
3 using parity as a guideline, as part of a broader effort to ensure adequate
4 food production. Following the War, at a time when price inflation was high
5 but agricultural cost inflation exceeded output price inflation, Congress
6 passed the Agricultural Act of 1949. This Act provided permanent authority
7 for the Secretary to support prices in a manner similar to that used during
8 the War. This was a mandatory program. As such, Congress obliged itself
9 to design a program that lived within their self-imposed budgetary rules,
10 but, once passed, the Secretary was required to implement it without regard
11 to cost.

12 In 1981, Congress suspended the authority of the Secretary to establish
13 a support price for milk within the 75-90% parity range and instead set a
14 specific, discrete support price for milk over which the Secretary had no
15 latitude to change. This suspension was not permanent, but it was renewed
16 in each successive Farm Bill until 2008, when the language of the legislation
17 was changed away from specifying a support price for milk to establishing
18 purchase prices for bulk, commodity cheddar cheese, butter and nonfat dry
19 milk. This altered program was labeled the Dairy Product Price Support
20 Program or DPPSP (as opposed to previous DPSP). In practice, this was a
21 very subtle change, as USDA effected the support price for milk by
22 establishing purchase prices for these same products. Under both versions
23 of this program, USDA offers to buy these dairy commodities at the
24 announced prices under the belief that if market prices drop to or below
25 these levels, manufacturers will begin offering eligible commodities to the



1 USDA, instead of private buyers. USDA is obliged to buy any and all
2 quantities of eligible products so offered. Insofar and manufacturers take
3 advantage of this guaranteed price outlet, market prices should not fall
4 below this government offer price, or at least by not very much.

5 The levels of the various supported prices before and after the passage
6 of the 2008 Farm Bill are listed in the following table.

Price	Before FCEA 08	After FCEA 08
Support Price for Milk Used in Manufacturing, average fat test	\$9.90	not specified
Purchase Price for Cheddar Cheese, blocks	\$1.1314	\$1.13
Purchase Price for Cheddar Cheese, barrels	\$1.1014	\$1.10
Purchase Price for Butter	\$1.05	\$1.05
Purchase Price for Nonfat Dry Milk	\$0.80	\$0.80

7 Although Congress specified a fixed support price for milk from 1981 to
8 2008, when it passed the Food, Conservation, and Energy Act of 2008 it
9 changed a few critical words from "shall be" to "shall be no less than". In so
10 doing, it created the authority for the Secretary of Agriculture to announce
11 higher purchase prices than those specified in the Act. This is the first time
12 since the early 1970s that the Secretary has had discretion on the level of
13 support for the price of milk, some 35 years.



1 It was under this new authority that Secretary Thomas Vilsack increased
2 the purchase prices for cheese and nonfat dry milk from August to October
3 2009. Compared to the purchase prices listed in the table above, the
4 Secretary increased the purchase price of cheeses by 18¢ per pound (16%)
5 and nonfat dry milk by 10¢ per pound (15%). This equated to about a
6 \$1.50 to \$1.80 increase in the implicit support to the farm price of milk for
7 those three months. This action resulted in little to no response by
8 manufacturers to sell product to CCC, but it arguably provided some
9 justification for some strengthening to market prices at that time.

10 In November, prices reverted to the levels specified in the FCEA 2008.
11 Many in the dairy producer community might ask, if the Secretary has this
12 authority, why did he not exercise it in early 2009 or even late 2008, when
13 prices were falling to their nadir. Or, why did the Secretary not extend the
14 higher levels for a longer period? Indeed, some 2000 letters were sent to
15 the Secretary this Spring asking for him to establish an \$18 per cwt support
16 price. (Under FCEA 2008, there is no support price for milk anymore, but it
17 would not be hard to translate this level to the purchase price equivalents.)

18 The answer to these questions lies in large part with the situation
19 described earlier in this report, where authority is differentiated from
20 budgetary ability. Although the FCEA 2008 does in deed provide authority to
21 the Secretary, this authority is ineffective if there are insufficient funds to
22 back up the implied obligation. When passing a bill, the Congressional
23 Budget Office, using budgetary guidelines created by Congress itself,
24 determines if Congress can afford to pass a bill that has budgetary
25 implications. Once a bill is in place, if it involves some discretionary action



1 or decisions by the Secretary, then the President's Office of Management
2 and Budget has the authority to decide if the Executive Branch can afford it.
3 Although the institutions are different, the process is very similar. Typically,
4 the Secretary would be asked to come up with the money for a costly
5 decision he would like to make. This means taking money from one
6 program to fund something in another program. Of course, there are
7 usually not enough funds to do everything you would like to do; so finding
8 some idle pot of money is unlikely. For the same kind of reason, OMB is not
9 likely to ask some other agency in the Executive to finance a program in
10 Agriculture. The net result is that a decision to increase the support price to
11 any level that is actually meaningful, i.e., USDA would actually incur an
12 expense, is stopped before it can get started.

13 Milk Income Loss Contract

14

Summary of the Milk Income Loss Contract (MILC)

Objectives:

Income Support - augment dairy farmer income when milk prices are low

Methods:

Provide a countercyclical payment to qualified dairy farmers when the Class I price announced for the Boston city zone of the Northeast Federal Milk Marketing Order falls below a legislatively specified value.

In addition to setting the benchmark or target price, the law also specifies a percentage of the difference between the between the target price and the announced price. The payment rate is based on that percentage.

Total payments are limited to an amount of milk marketings (pounds of milk).

In each marketing year, qualified dairy farmers must elect the month in which they are first eligible to begin receiving a monthly MILC supplement. Payments are made in each consecutive month in which a payment is due until the limit on marketings is reached, regardless of the dollar amount of the payment.



Summary of the Milk Income Loss Contract (MILC)

Legal Authority:

Food, Conservation and Energy Act of 2008 (FCEA). Legislative origin traces to emergency market transition assistance authorized under the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 2000 (H.R.1906). The MILC was first formally authorized as such under the Farm Security Act of 2002 (FSA).

Administering Agency:

U.S. Department of Agriculture - Farm Services Agency
Farm Programs - Price Support Division

1
2 The Milk Income Loss Contract is a form of countercyclical income
3 support that was devised with some elements drawing from the structure of
4 the one-time Northeast Dairy Compact and the countercyclical price
5 subsidies established for program crops (food and feed grains, etc) in the
6 Farm Security Act of 2002.

7 The Northeast Dairy Compact was a Congressionally sanctioned
8 agreement between the six New England states to coordinate a minimum
9 price for Class I milk marketed in their jurisdiction. The Compact granted
10 authority to set a minimum Class I price of \$16.94 per cwt. that all buyers of
11 Class I milk were required to pay, either as a premium above the federally
12 regulated Class I price or as a price established for any federally unregulated
13 handler. Inasmuch as this price premium applied only to Class I milk, the
14 total money collected in any given month was pooled and shared pro rata
15 among all farmers in New England or delivering milk to a New England
16 bottler. The minimum Class I price was announced relative to the the
17 Boston city zone of what was then Federal Order 1, the New England Order.



1 When Congressional approval for this multi-state Compact expired, the
2 design of the Class I premium was adapted to a countercyclical income
3 subsidy that would apply to all dairy farmers in the contiguous United
4 States. The Boston city zone price of \$16.94 was established as the price
5 trigger. A payment rate was determined as a percentage of the difference
6 between the announced monthly price and the trigger. The percentage
7 chosen approximated the percentage of Class I milk in the US (about 40%).
8 In addition, a payment limit was established based on the pounds of milk
9 marketed by a farm entity. The quantitative limit represents a type of
10 payment limitation that has two effects or objectives. It limits government
11 exposure to budget costs and thus can be used to keep the program costs
12 within budgetary maximums. Furthermore, it targets benefits towards
13 smaller scale farmers, achieving a general policy objective that has had
14 broad support in Congress. In this framework, the actual expenditures
15 depend on the magnitude of the payment rate as well as the marketings
16 payment limit. An individual farm can achieve the maximum payment limit
17 with a very small subsidy or a very large subsidy depending on the payment
18 rate for any given month. Inasmuch as many farms market more milk in a
19 year than the annual payment limit, farmers are allowed to choose the
20 month within a marketing year in which they wish to be eligible to receive a
21 payment. Payment will begin in that month or the first month thereafter in
22 which a payment rate is announced and continue until the marketing
23 payment limit is reached. The marketing year begins in October, and the
24 payment limit resets to zero at that time.



1 Congress has periodically changed the payment rate percentage and the
2 payment limit. In 2008, it also modified the trigger price to include an
3 automatic adjustment for changes in the prices farmers pay for certain feeds
4 used in a dairy ration. The national dairy ration cost is routinely calculated
5 by USDA's National Agricultural Statistics Service. The automatic
6 adjustment is triggered when the monthly ration costs exceeds \$7.35 per
7 cwt but the trigger price is increased by 45% of the relative difference
8 between the ration cost trigger and the estimated actual cost. For example,
9 if the dairy ration cost is estimated to be 10% above \$7.35, the milk
10 payment trigger rises 4.5% (or $\$16.94 \times 1.045 = \17.70)

11 The program is administered by the Farm Service Agency of the U.S.
12 Department of Agriculture and is a mandatory program over which USDA
13 has no discretionary authority. USDA does promulgate rules to interpret and
14 enforce the program as authorized by Congress. These rules define
15 requirements for eligibility and compliance, and the like, but they do not
16 alter the fundamental parameters specified in legislation.

17 Federal Milk Marketing Orders

18



Summary of Federal Milk Marketing Orders (FMMO or FO)

Objectives:

- Create market conditions that will encourage:
 - Orderly marketing activity; markets that function smoothly, predictably, and at a reasonable cost
 - Orderly pricing (predictable but not necessarily stable or adequate)
 - Adequate and wholesome supplies of fluid milk
 - Equitable returns to farmers, equitable prices for processors

Methods:

- Regulate and supervise the terms of trade between farmers and processors, by setting minimum farm level prices and trading rules that determine who qualifies for what price, so as to create market (price) incentives that result in desired market behavior or performance
- The fundamental and legislatively mandated tools are:
 - Classification of producer milk according to the product in which it is used
 - Pricing of milk according to class
 - Pooling the values paid by processors for each class of milk to return a common "pool" price to all producers, regardless of the actual destination of their milk
 - Auditing to ensure and enforce compliance by regulated handlers

Legal Authority:

Agricultural Marketing Agreement Act of 1937 (as amended)

Administering Agency:

U.S. Department of Agriculture - Agricultural Marketing Service - Dairy Programs

1
2 Federal Milk Marketing Orders are the oldest of dairy industry specific
3 programs. The concept of using classified pricing and pooling was originally
4 developed by milk marketing cooperatives operating in the New England
5 area during the late 1800s. The concept was predicated on the notion that
6 milk used for fluid or beverage purposes has a different economic value than
7 milk used for manufacturing, but that Grade A milk can be used in any of a
8 number of products. To ensure that all producers of Grade A milk received a



1 fair and equitable return, all year around, cooperatives developed this
2 method for establishing prices of milk based on its use (classified pricing)
3 and sharing the average value of milk in all uses to all Grade A farmers
4 (pooling). The latter was established in particular to eliminate destructive
5 competition among farmers who would otherwise have incentives to seek
6 the highest class price and thereby ensure that farm milk was transported in
7 a manner consistent with minimizing marketing costs.

8 This general concept was adopted under both federal and state laws
9 beginning in the 1930s, as elected officials sought methods to bring price
10 relief to dairy farmers during the Great Depression. Over time, most state
11 laws gave way to the federal law due to their inability to price milk in
12 interstate trade and for regulatory efficiency. However, there remain several
13 states that continue to have some form of milk price regulation. These state
14 orders typically use a form of classified pricing and pooling very similar to a
15 federal order, but they may also involve a simple price premium that is
16 applied to FMMO prices that pertain to regulated handlers in their state.
17 These states are California, New York, Pennsylvania, Virginia, Maine,
18 Montana, Nevada, North Dakota. In only CA, NV and ND are all state based
19 processors regulated by the State.

20 The concept of an Order is predicated on the assumption that the
21 marketing of milk is inherently regional and subject to a geographic
22 description and boundary. The marketing area is defined by the area in
23 which a group of fluid milk processors routinely compete for the sale of
24 packaged milk. It is not expected that this is an impermeable boundary, but
25 the size of a marketing area may be smaller or larger as nature of



1 competition among fluid milk processors dictates. Understandably,
2 marketing areas have become larger and larger over time. Consequently,
3 FMMO areas have evolved from city-sized areas to large areas spanning
4 several states. Fluid milk processors are automatically subject to the
5 requirements of a FMMO. Manufacturers of other dairy products are not
6 automatically regulated. Instead, manufacturers are required to
7 demonstrate that in some fashion they are part of a coordinate supply of
8 milk that benefits the fluid milk market, especially in times of year when the
9 supply of milk is short relative to the demand for Class I milk. The specific
10 performance or pool qualification requirements vary to some extent across
11 Orders, to meet conditions of each area, but the general concept is the same
12 everywhere. Once the set of plants that are subject to the regulation of an
13 Order is determined, the each regulated handler is obliged to pay a
14 minimum class price for milk based on how the handler uses the milk it
15 purchases. Although handlers tend to be specialized, the price(s) they owe
16 are based on how each pound they purchase is used. A plant may
17 predominantly process Class I milk or Class III milk, but a plant is not a
18 Class I plant *per se*, so much as it is a plant that uses milk in Class III
19 products.

20 The basic idea of Federal Orders is fairly simple, but the actual
21 implementation is quite complex. Anyone interested in more specific details
22 of their operation is referred to the resources available from the US
23 Department of Agriculture. Only two additional observations are highlighted
24 here.



1 First, Federal Orders are allowed under the AMAA of 1937, they are not
2 mandated or required. Thus, the Act authorizes the Secretary to establish a
3 FMMO subject to a request from producers in a marketing area and a
4 subsequent formal hearing to determine the need for an Order and some
5 specific requirements or characteristics of the marketing area. Upon review
6 of the evidence presented in the formal hearing, and only that evidence, the
7 Secretary may recommend a specific set of regulations for the farmers and
8 buyers in that area. This set of regulations is called the Order. Farmers who
9 would be regulated under the Order, and only they, have the privilege of
10 voting for or against the Order proposed by the Secretary; however, the
11 must vote for the Order in its entirety. They are not allowed to only pick the
12 parts they like. The AMAA of 1937 requires the Secretary to craft Orders
13 that are "in the public interest". As such, the Secretary has to balance the
14 legitimate need and concerns of farmers, processors, and consumers. In so
15 doing, s/he may choose some provisions that are not particularly favored by
16 dairy farmers. Thus, the exclusive privilege farmers have to vote for a
17 Federal Order is balanced by the "all or nothing" condition of the vote. An
18 Order is approved if two-thirds of the dairy farmers who prices would be
19 subject to the Order vote in favor of it. If their milk marketing cooperative
20 allows it, a Cooperative may cast a "bloc vote" on behalf of all their farmers.
21 The conditions framing any limitations on a bloc vote are determined by
22 farmers as members of the cooperative.

23 Because Federal Orders are voluntary, it took quite some time to
24 develop the system of Federal and State Orders that envelop the US today.
25 Although first authorized in 1937, Federal Orders did not cover more than



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1 half of the US milk supply until the mid-1960s. Today, marketing orders
2 cover about two-thirds of the US milk supply. California alone regulates
3 over 20% of the US milk supply. The majority of the remaining 10-15% is
4 regulated by other States (cf. above). The largest amount of milk not
5 regulated by the USDA or a State is in Idaho. This may amount to about 5%
6 of the US milk supply.

7 The second major highlight is that the process for changing a Federal
8 Order is as formal and complex as the process for promulgating or starting
9 one. Both processes are made be request or petition to USDA. A request to
10 amend an Order may be approved or denied. If approved, the apparatus of
11 formal rule-making applies. This requires that a formal announcement be
12 made, which defines the scope of the hearing. A formal hearing is held.
13 USDA make a recommendation based on the evidence of the hearing and
14 the strictures of the AMAA. A majority of farmers who would be regulated
15 under an amended order must approve the recommended order in its
16 entirety. Under new rules established under the FCEA, the process for
17 amending an order may be completed in as little as about 12 months;
18 however, it remains the case that all changes to a federal order must follow
19 the requirements of formal rulemaking and no matter how broad producer
20 support for a change might be, USDA must balance all interests, including
21 the public interest, when it makes a recommendation for a change.



1 Dairy Export Incentive Program

Summary of the Dairy Export Incentive Program (DEIP)

Objectives:

Increase sales of US dairy products in foreign market, particular to countervail export subsidies from other suppliers (e.g., the EU)
Encourage dairy product marketers to develop export sales

Methods:

Provide "bonuses" or cash subsidies to dairy product exporters by supplementing privately negotiated export prices. When DEIP authorizations are announced, USDA establishes a quantitative target for export sales and invites private sellers to negotiate an export sale at the best price they can obtain, then apply for a price subsidy.

Legal Authority:

Created under the Dairy Production Stabilization Act of 1983 and initiated in May 1985, Reauthorized under the Agriculture, Conservation, and Trade Act of 1990, the Uruguay Round Agreements Act of 1995, and the Federal Agriculture Improvement and Reform Act of 1996

Administering Agency:

U.S. Department of Agriculture - Foreign Agricultural Service

2 (<http://www.fas.usda.gov/exportprograms.asp>)

3 The Dairy Export Incentive Program (DEIP) helps exporters of U.S. dairy
4 products make sales for foreign buyers when US prices exceed prevailing
5 world prices for targeted dairy products and destinations. As part of its
6 World Trade Organization commitments resulting from the Uruguay Round
7 Agreement on Agriculture, annual export subsidy ceilings are set for each
8 commodity. These define a maximum quantities and a maximum budgetary
9 expenditures, which is charged against the US in the calculation of allowable
10 but constrained subsidies under the WTO agreement. All sales under the
11 DEIP are made by the private sector, not the U.S. government.



1 An invitation for offers issued by USDA may be one of two types: those
2 inviting exporters to submit a competitive offer for a bonus, and those
3 inviting exporters to apply for an announced bonus. Once an invitation for
4 offers is issued, it is up to agricultural exporters to contact prospective
5 buyers in eligible countries and negotiate a sales contract covering price,
6 quantity, quality, delivery, and other terms. The sale may be contingent on
7 USDA's approval of a bonus. Each prospective exporter submits an offer to
8 USDA requesting a bonus that would allow the sale to take place at the
9 agreed price.

10 Under an invitation for competitive offers, USDA reviews all bids for the
11 competitiveness of the bonus value requested and compares the bids with
12 offers from other U.S. exporters and with sales of competitor countries.
13 Under an announced bonus, compliant offers meeting all program
14 requirements are accepted on a first-come, first-served basis. USDA has the
15 right to reject any or all bids.

16 Once USDA accepts a bid, the exporter and USDA's Commodity Credit
17 Corporation (CCC) enter into an agreement. The bonus is paid to the U.S.
18 exporter in cash. The CCC determines the bonus payment by multiplying the
19 bonus specified in the agreement by the net quantity of the commodity
20 exported. Once an exporter furnishes USDA with evidence that the specified
21 commodity has been exported to the target destination under the terms of
22 the agreement, the exporter can request payment of the bonus.

23 In implementing the program, USDA has taken the position that in order
24 for use of DEIP to be justified under the Uruguay Round agreement, US
25 prices should be above prices in international markets and the claim that we



1 are countervailing other countries' subsidies should be plausible. In recent
2 years, US and "world" prices have been closely aligned for the basic dairy
3 commodities, such as nonfat dry milk; hence, the economic and legal
4 justification for an export subsidy has been weak. Moreover, the EU has
5 seriously reduced its very high level of dairy export subsidies as part of its
6 own agricultural policy reform in the last few years, thereby diminishing the
7 countervailing argument. The EU did resume export subsidies following
8 price supporting actions it took in response to 2009, but its longer term
9 commitment to dismantling dairy industry support programs is genuine and
10 continuing.

11 While DEIP is the program designed specifically to enable dairy product
12 exports, FAS has a number of programs that are intended to enable or assist
13 US agricultural and food exporters. These range from export promotion
14 activities (such as trade shows and more personal tours and visits) to
15 programs that facilitate commercial transactions. An export credit
16 guarantee for commercial financing of U.S. agricultural exports is a valuable
17 tool used by many agricultural industries. These Commodity Credit
18 Corporation programs provide a credit guarantee to a foreign bank to whom
19 the foreign buyer has applied for a letter of credit or similar instrument and
20 for which the funds will be used to buy agricultural or food products subject
21 to a privately negotiated contract that is otherwise completed.

22 CCC Charter Act, Section 5

23 The Commodity Credit Corporation (CCC) is a Government-owned and
24 operated entity that was created in 1933 to handle commercial transactions
25 that involve agricultural commodities. It is used in various programs that



1 exist to stabilize, support, and protect farm income and prices. CCC also
2 facilitates the movement of surplus or other agricultural commodities to
3 various government and non-governmental outlets.

4 The CCC was formally (re)chartered in 1948 under the Commodity
5 Credit Corporation Charter Act. This legislation establishes the general
6 purpose of the CCC and its general operating rules and authorities. Section 5
7 of the Act is excerpted below. In this section, various authorities are
8 granted that relate to the acquisition and disbursement of agricultural
9 commodities.

10 *SEC. 5. [15 U.S.C. 714]*

11 *SPECIFIC POWERS.—In the fulfillment of its purposes and in carrying*
12 *out its annual budget programs submitted to and approved by the*
13 *Congress pursuant to Chapter 91 of Title 31, the Corporation is*
14 *authorized to use its general powers only to —*

15 *Support the prices of agricultural commodities (other than tobacco)*
16 *through loans, purchases, payments, and other operations.*

17 *(b) Make available materials and facilities required in connection with*
18 *the production and marketing of agricultural commodities (other than*
19 *tobacco).*

20 *(c) Procure agricultural commodities (other than tobacco) for sale to*
21 *other Government agencies, foreign governments, and domestic,*
22 *foreign, or international relief or rehabilitation agencies, and to meet*
23 *domestic requirements.*

24 *(d) Remove and dispose of or aid in the removal or disposition of*
25 *surplus agricultural commodities (other than tobacco).*



1 (e) Increase the domestic consumption of agricultural commodities
2 (other than tobacco) by expanding or aiding in the expansion of
3 domestic markets or by developing or aiding in the development of
4 new and additional markets, marketing facilities, and uses for such
5 commodities.

6 (f) Export or cause to be exported, or aid in the development of
7 foreign markets for, agricultural commodities (other than tobacco)
8 (including fish and fish products, without regard to whether such fish
9 are harvested in aquacultural operations).

10 (g) Carry out conservation or environmental programs authorized by
11 law.

12 Carry out such other operations as the Congress may specifically
13 authorize or provide for.

14 In the Corporation's purchasing and selling operations with respect to
15 agricultural commodities (other than tobacco) (except sales to other
16 Government agencies), and in the warehousing, transporting,
17 processing, or handling of agricultural commodities (other than
18 tobacco), the Corporation shall, to the maximum extent practicable
19 consistent with the fulfillment of the Corporations purposes and the
20 effective and efficient conduct of its business, utilize the usual and
21 customary channels, facilities, and arrangements of trade and
22 commerce (including, at the option of the Corporation, the use of
23 private sector entities).

24 This Section of the legislation defines a number of things that the CCC
25 may do; however, this is a good deal different from actually being able to
26 do, or being required to do, something. It is under these general authorities



1 that the Secretary is able to implement the procurement and sale of dairy
2 products under the DPPSP and various other programs related to domestic
3 and international food assistance. It is in the legal and financial
4 authorizations of these other programs that CCC is specifically enabled to,
5 say, buy a load of 600 pound barrel cheese, have it converted to 5 pound
6 loaves of processed cheese, and then distribute the processed cheese to
7 schools, prisons, or a food provider in a less developed country.

8 If there is no specific program that requires the Secretary to procure
9 and/or distribute dairy or other commodities, he could use the provisions of
10 this Charter to do so under his discretion if and only if there is a source of
11 funds to do so. Permission to spend money in this fashion must be given by
12 the President's Office of Management and Budget (OMB), which is described
13 and discussed in a later section

14 Various Domestic Food Assistance Programs

15 The single largest share of the budget of the US Department of
16 Agriculture, some X%, is devoted to food and nutrition programs. These
17 programs are generally administered through the Food and Nutrition Service
18 and include the following:

- 19 A. Supplemental Nutrition Assistance Program (SNAP, formerly Food
- 20 Stamps)
- 21 B. Women, Infants, and Children (WIC)
- 22 C. School Meals
 - 23 1. National School Lunch
 - 24 2. Fresh Fruit and Vegetable Program
 - 25 3. School Breakfast Program
 - 26 4. Special Milk Program
 - 27 5. Team Nutrition
- 28 D. Summer Food Service Program



- 1 E. Child and Adult Care Food Program
- 2 F. Food Assistance for Disaster Relief
- 3 G. Food Distribution
- 4 1. Schools/Child Nutrition Commodity Programs (CNP)
- 5 2. Food Distribution Program on Indian Reservations
- 6 3. Nutrition Services Incentive Programs (CNP)
- 7 4. The Commodity Supplemental Food Program (CSFP)
- 8 5. The Emergency Food Assistance Program (TEFAP)
- 9

10 Each of these programs is described at the FNS website, among other
11 sources (<http://www.fns.usda.gov/fns/>). Obviously, all of these programs
12 but one are not exclusive to milk and dairy products, but many of these
13 programs have played a very important role in increasing the availability and
14 use of dairy products among children and needy people.

15 The Special Milk Program provides cash subsidies to schools for milk
16 they serve to children not covered under the School Lunch and similar
17 programs.

18 USDA provides grants to States, which in turn have primary
19 responsibility for delivering WIC program benefits to pregnant women,
20 women with young children and those infants and young children.
21 Historically, WIC has had a strong emphasis on providing milk and other
22 nutritious dairy products to this very important target group.

23 TEFAP was originally started during the early 1980s when surpluses
24 under the DPSP became enormous. Many elderly and other needy US
25 citizens benefitted from donations of surplus cheese and butter. The success
26 of the Temporary Emergency Food Assistance Program led to the creation of
27 The Emergency Food Assistance Program. Today, TEFAP is the primary



1 vehicle for distributing commodity foods to States, that in turn distribute
2 food to Food Banks and similar local food distribution agencies.

3 Each of these programs can be a vehicle for the use and distribution of
4 dairy foods. Virtually all have done so in the past, some to a very significant
5 degree. However, two key factors limit their effectiveness as a short term
6 response to a dairy surplus.

7 First, these programs are budgeted. They have a certain amount of
8 funding that is controlled by Congressional appropriations and/or more
9 discretionary decisions of OMB. USDA may be able to shift some funding
10 around but it can't make the pie bigger. Even shifting money is difficult if
11 not practically impossible as there are always numerous legitimate claims on
12 available funds.

13 Second, these programs involve and require considerable time for
14 planning, implementation, and execution. Programs that coordinate with
15 State run activities, dovetail into State planning and timing and ultimately
16 the distribution and use of food or food subsidies is subject to some
17 discretion by the receiving State. Programs in which USDA works directly
18 with an agency typically involve a spending and utilization plan of that
19 agency. Schools, in particular, plan their budgets early in the calendar for
20 implementation in the coming school year that starts in August or
21 September. Once in place, it is difficult to impossible to change these plans.

22 Congress can certainly create funding and programs to respond to
23 something like the dairy crisis of 2009, but once funding for food and
24 nutrition programs are established it is next to impossible for the Secretary



1 to alter the plan or find additional funding to support one agricultural or food
2 sector.

3 Various International Food Assistance Programs

4 There are a number of programs that have been designed to provide
5 food to needy people in low income countries on an ongoing or emergency
6 basis or to provide emergency assistance in a time of natural or other
7 specific disaster. These include:

- 8 A. Food for Peace
 - 9 B. McGovern-Dole
 - 10 C. Food for Progress
 - 11 D. Section 416(b)
- 12

13 The granddaddy of all international food assistance programs is Food for
14 Peace. This program was first authorized under the Agricultural Trade
15 Development and Assistance Act of 1954, at a time of agricultural surpluses.
16 At first considered a temporary response to deal with agricultural surpluses,
17 this program has evolved to become an icon of US food assistance,
18 considered a core program by advocates for low income countries. Using
19 the section of the law in which this Act was codified, the program was
20 routinely referred to as Public Law 480 or P.L. 480. Today it is called by the
21 legislation which defines its current parameters - The Food for Peace Act.
22 The FPA has three titles, and each title has a specific objective and provides
23 assistance to countries at a particular level of economic development. Title I
24 is administered by USDA. Titles II and III are administered by USAID - the
25 U.S. Agency for International Development. USAID is an independent
26 federal agency that operates under the supervision of the Secretary of State.



1 <http://www.fas.usda.gov/excredits/FoodAid/pl480/pl480.asp>

2 FPA, Title I–Trade and Development Assistance, provides for
3 government-to-government sales of U.S. agricultural commodities to
4 developing countries on credit or grant terms. Agreements under the Title I
5 credit program may provide for repayment terms of up to 30 years with a
6 grace period of up to 5 years. The authority also allows for grant programs,
7 which have outnumbered loans in recent years. Depending on the
8 agreement, commodities provided under the program may be sold in the
9 recipient country and the proceeds used to support agricultural, economic,
10 or infrastructure development projects.

11 Since fiscal year 2006, new funding has not been requested because
12 demand for food assistance using credit financing has fallen or grant
13 programs have been a more appropriate tool.

14 FPA, Title II–Emergency and Private Assistance, provides for the
15 donation of U.S. agricultural commodities to meet emergency and non-
16 emergency food needs in other countries, including support for food security
17 goals.

18 FPA, Title III–Food for Development, provides for government-to-
19 government grants to support long-term growth in the least developed
20 countries. Donated commodities are sold in the recipient country, and the
21 revenue generated is used to support economic development programs. In
22 recent years, this title has been inactive.

23 Although the Secretary of Agriculture is responsible for Title I uses of
24 agricultural commodities, he can't do much of the program is not funded. In



1 recent years, advocates for international food assistance have strongly urged
2 that Congress convert any support for using US grown and exported food in
3 needy countries to direct cash subsidies that would allow foreign
4 governments or approved agencies in foreign countries to buy food wherever
5 they can find it most cheaply. It is argued that this approach would provide
6 the most food assistance bang for the buck, but of course this would not
7 provide much support for US agriculture.

8 The McGovern-Dole International Food for Education and Child Nutrition
9 Program helps promote education, child development, and food security for
10 some of the world's poorest children. It provides for donations of U.S.
11 agricultural products, as well as financial and technical assistance, for school
12 feeding and maternal and child nutrition projects in low-income countries.
13 The program was authorized by the Farm Security and Rural Investment Act
14 of 2002 and is administered by the Foreign Agricultural Service.

15 The commodities are made available for donation through agreements
16 with private voluntary organizations (aka, PVO or NGO, for non-
17 governmental organizations), cooperatives, intergovernmental organizations,
18 and foreign governments. Commodities may be donated for direct feeding
19 or, in limited situations, for local sale to generate proceeds to support school
20 feeding and nutrition projects.

21 Under the Food for Progress Act of 1985, agricultural commodities are
22 provided to developing countries and emerging democracies committed to
23 introducing and expanding free enterprise in the agricultural sector.
24 Commodities are currently provided on a donation basis to foreign



1 governments, private voluntary organizations, nonprofit organizations,
2 cooperatives, or intergovernmental organizations.

3 The implementing organizations request commodities and USDA buys
4 those commodities from the U.S. market. USDA donates the commodities to
5 the implementing organizations and pays for the freight to move the
6 commodity to the recipient country.

7 The Section 416(b) program is authorized by the Agricultural Act of
8 1949, as amended. This program provides for overseas donations of surplus
9 commodities acquired by the Commodity Credit Corporation (CCC).
10 Donations may not reduce the amounts of commodities that are traditionally
11 donated to U.S. domestic feeding programs or agencies, and may not
12 disrupt normal commercial sales.

13 Availability of commodities under Section 416(b) depends on CCC
14 inventories and acquisitions, and programming varies from year to year. The
15 commodities are made available for donation through agreements with
16 foreign governments, PVOs, cooperatives, and intergovernmental
17 organizations. Depending on the agreement, the commodities donated under
18 Section 416(b) may be sold in the recipient country and the proceeds used
19 to support agricultural, economic, or infrastructure development programs.

20 The Section 416(b) program is currently not active, as there are no
21 CCC-owned commodities available at this time.

22 **The Office of Management and Budget**

23 A persistent theme in this review has been that the Secretary of
24 Agriculture can only initiate and operate programs 1) which he is authorized



1 to administer and 2) which have a well-defined mandatory or discretionary
2 source of funding. If the program is mandatory, Congress provides authority
3 to spend whatever money is required to achieve the purposes of the Act. If
4 the program is discretionary, Congress may or may not provide funding to
5 support the program. When funding is limited, which of course is the
6 general rule, the Office of Management and Budget plays a crucial role in
7 determining what can and what may be done.

8 The following is excerpted from the website of the President's Office of
9 Management and Budget. It describes the structure and role of the OMB.

10 *The Mission and Structure of the Office of Management and Budget*

11 *The core mission of OMB is to serve the President of the United States*
12 *in implementing his vision across the Executive Branch. OMB is the*
13 *largest component of the Executive Office of the President. It*
14 *reports directly to the President and helps a wide range of executive*
15 *departments and agencies across the Federal Government to*
16 *implement the commitments and priorities of the President.*

17 *As the implementation and enforcement arm of Presidential policy*
18 *government-wide, OMB carries out its mission through five critical*
19 *processes that are essential to the President's ability to plan and*
20 *implement his priorities across the Executive Branch:*

21 *Budget development and execution*, a significant government-wide
22 *process managed from the Executive Office of the President and a*
23 *mechanism by which a President implements decisions, policies,*
24 *priorities, and actions in all areas (from economic recovery to health*
25 *care to energy policy to national security);*



1 Management — oversight of agency performance, Federal
2 procurement, financial management, and information/IT (including
3 paperwork reduction, privacy, and security);

4 Coordination and review of all significant Federal regulations by
5 executive agencies, to reflect Presidential priorities and to ensure
6 that economic and other impacts are assessed as part of regulatory
7 decision-making, along with review and assessment of information
8 collection requests;

9 Legislative clearance and coordination (review and clearance of all
10 agency communications with Congress, including testimony and draft
11 bills) to ensure consistency of agency legislative views and proposals
12 with Presidential policy; and

13 Executive Orders and Presidential Memoranda to agency heads and
14 officials, the mechanisms by which the President directs specific
15 government-wide actions by Executive Branch officials.

16 http://www.whitehouse.gov/omb/organization_mission/

17 It is in its role as the President's budget watchdog that OMB has
18 significant influence on the spending ability of any federal agency, including
19 USDA and the Secretary of Agriculture. When Congress has provided a clear
20 mandate and sufficient funding to conduct a program, OMB's only concern is
21 the efficient execution of the required program. However, when an
22 authorized program is unfunded or underfunded the Secretary must work
23 with OMB to determine where funding might be available or even whether
24 any such funding can be found. Inasmuch as OMB reports to the President,
25 its priorities, both programmatically and from the standpoint of financial



1 stewardship, are driven by the President’s overarching priorities. In periods
2 when budgets are tight, OMB tows a hard line on discretionary spending.
3 Even when budgets have some slack, OMB will and must evaluate tradeoffs
4 when an Executive agency, like USDA, makes a request. Needless to say,
5 when there is some slack in the budget, this is well known. Demand always
6 exceeds supply in the world of the US budget.

7 Farm Loan Programs

8 [should we include a section of various FSA lending authorities that can
9 be used by dairy farmers for investment or operating loans? Not dairy
10 specific but certainly used by dairy farmers?}

11 Market News, Research, and Promotion Programs

12 Numerous programs exist to support dairy market development, day-
13 to-day dairy business decisions, and the ability of dairy businesses to plan.
14 They do so by providing information on milk and dairy product prices,
15 market conditions, and the market outlook. Such programs include the AMS
16 Dairy Market News, various data serials published by NASS, ERS, and FAS,
17 special analytical reports by ERS and WASDE. USDA also has certain
18 programs for market and business development and AMS participates in the
19 oversight of the National Dairy Promotion and Research Board.

20 These programs typically provide valuable information for buyers and
21 sellers in dairy markets. While useful in the long term, they are not
22 programs that can be easily utilized for short term effects or benefits.

23 **In Conclusion** 24



1 The essence of this review and report is that there are numerous
2 programs which could or have been used to benefit dairy farmers and the
3 dairy sector in times of stress. This include programs to directly support
4 prices or farm incomes and programs that more indirectly affect the demand
5 for dairy products and thereby strengthen markets and prices. At present,
6 there are no programs to reduce supply and achieve price benefits from that
7 perspective.

8 In theory, all of these programs could be extremely helpful in times of
9 economic stress, but in practice, these programs are not well suited to
10 unanticipated stress and quick responses to emergency conditions. In many
11 cases, the Secretary of Agriculture has no authority to change a program or
12 operate it outside of a very narrow range of legislatively defined parameters.
13 In some cases, the law grants the Secretary some discretion is defining a
14 program's parameters, but when the Secretary's decisions have an impact
15 on government expenditures, even a Secretary must get approval from the
16 President's Office of Management and Budget. Since its creation in 1922,
17 this office has played the role of budget watchdog. While the specific
18 economic policies and priorities of Presidents certainly change over time,
19 OMB's job is to carefully and cautiously steward the resources Congress
20 provides to the Executive Branch. There are many competing demands for
21 many worthy needs. Obtaining permission to use discretionary authority for
22 agricultural programs in general and dairy in particular has proven difficult
23 across recent administrations.

24 Whether the White House or USDA could use existing authorities to
25 improve economic conditions for dairy farmers, especially in 2009 or



1 currently is not in question. Whether full advantage was taken of existing
2 authorities, or whether better advantage could be made of existing
3 authorities in the near future is subject to debate. In theory, the answer is
4 yes, but in practice the answer is more difficult. It is also important to
5 understand that the question may be posed by the Secretary of Agriculture
6 but even this high level of Cabinet officer lacks the authority to exclusively
7 answer that question.

8 **Future Considerations for the Use of Existing Programs**

9 In 2009, the Secretary took a number of steps to try to lessen the
10 downturn in the dairy sector. One was the discretionary and temporary
11 increase in purchase prices from August to October, mentioned above. He
12 also implemented programs to provide supplemental income subsidies to
13 dairy farmers and to purchase foodservice-sized packages of selected dairy
14 products for distribution in food assistance programs. Both of the latter
15 were made possible by a special congressional appropriation.

16 If (or when) markets turn severely negative for dairy farmers again and
17 if the available tools are those that are presently in place, what might we
18 recommend the Secretary to consider or do?

19 Barring legislative changes, the two programs that permit the Secretary
20 some flexibility are the Dairy Product Price Support Program and one or
21 more food assistance programs. If the Secretary can identify sources of
22 money, it would be possible for him to stimulate demand and thereby lift
23 prices via either of these approaches. In the case of the DPPSP, the extra
24 "demand" comes in the form of government purchases that aim to move
25 cheese, butter, and/or nonfat dry milk off of the commercial market.



1 Typically, any such product so acquired will either be sold back into
2 commercial markets at the sellback price or will be made available for use in
3 a food assistance program (possibly under Sec. 416(b) or one of the
4 domestic programs, such as TEFAP or School Lunch). The distinguishing
5 feature here is that USDA buys a limited type of bulk dairy commodity at a
6 fixed price and then tries to find a good or least loss use for it.

7 In the case of TEFAP, School Lunch and the like, additional funding
8 could be used to simply do more of what each program is designed to do.
9 This does not involve setting a price target, but the fact that USDA would be
10 creating a kind of new demand for these products would have a competitive
11 effect on market prices when the market is soft. To ensure that the USDA
12 purchases did not simply displace a commercial sale, care would have to be
13 involved to ensure that government purchased dairy foods donations did not
14 simply displace commercial sales. Presumably, moving product through food
15 assistance programs means that dairy foods are being provided to people
16 who would not otherwise purchase them. The distinguishing characteristic
17 here is that USDA is enabling the purchase of dairy foods that users in these
18 food assistance programs want and the pricing is competitive around a
19 product specification that is consistent with users' needs.

20 As a general rule, the DPPSP approach is likely to be able to buy more
21 milk equivalent amounts but using the products to a good purpose is harder.
22 The supplemental funding for a food assistance purpose has the flip side
23 effect. It would likely result in less milk equivalent sales for a given amount,
24 but the product would more likely be put to good use for groups that had
25 been previously identified as needy and deserving of assistance.



1 One obvious question is when should the Secretary invoke one of these
2 options, or indeed which option. If these approaches are used too
3 frequently, then they lose their ability to be a countercyclical offset. Should
4 their use be entirely discretionary or should it be tied to a market indicator,
5 or should human discretion be reduced some sort of trigger determine what
6 a Secretary can do and when?

7 The advantage of being totally discretionary is that the Secretary and
8 his advisers can take into account a full range of market issues and policy
9 objectives. The advantage of a trigger is that the industry has more
10 certainty about when or under what conditions something will happen. This
11 has the obvious benefit of reducing market risk.

12 One alternative (or We suggest) that USDA use the Milk Income over
13 Feed Cost measure proposed by NMPF in its Foundation for the Future
14 proposal as a trigger for a countercyclical intervention. {perhaps propose a
15 two or three trigger levels. If above X, do nothing. If below X but above Y,
16 do something. If below Y, pull out more of the stops.} Within this
17 framework, we suggest that the Secretary have the flexibility to use either
18 DPPSP or a demand based program, or some combination of both, based on
19 USDAs assessment of what would be most effective in mitigating prices
20 without disrupting commercial markets. Alternatively, one might suggest
21 that at the first trigger, a demand program be used, but at the second
22 trigger the DPPSP be invoked.

23 [two more recommendations are offered here to stimulate further
24 discussion]



1 First, we recommend that the Secretary of Agriculture use his office to
2 advocate for new authorities and funding that would enable USDA to
3 respond to emerging economic emergencies with countercyclical or offsetting
4 actions that would expand the usage and availability of milk and dairy
5 products under existing programs. This could involve cash subsidies
6 targeted at a category of products or the provision of bonus commodities
7 acquired by USDA, such as would occur under the DPPSP and through Sec.
8 416(b). Numerous programs exist that could work, if only funding would
9 allow it. At present, programs that exist to mitigate agricultural disasters
10 are framed around natural disasters that limit production of a crop. Such
11 programs are extremely valuable to farmers, but economic disasters of the
12 type experienced in 2009 are obviously of a very different type.
13 Nevertheless, the logic that stimulates help in the time of crop failure that
14 threatens farm income also applies to low and negative farm incomes that
15 are the result of economic circumstances that are beyond the control of
16 farmers. A countercyclical approach to providing relief through expanded
17 sales of dairy products through programs that are designed to help needy
18 people at home and abroad could go a long way to assisting farmers through
19 unusually difficult times. Such programs must be able to expand quickly and
20 significantly when market conditions warrant. They must have a
21 countercyclical structure if they are to have a countercyclical effect.

22 Second, USDA should routinely reserve some of its annual funding for
23 food assistance and other programs to allow for midyear responses to
24 unexpected events. A specific amount or share of funding is not
25 recommended. It is expected that such uncommitted funding would



1 represent a fairly small share of the total allocation, perhaps 10-15%, but
2 we believe this operational strategy would provide the Secretary with a
3 greater and much needed ability to respond more quickly to economic
4 conditions that arise suddenly. If legal constraints exist that are imposed by
5 Congress or regulatory constraints exist that are imposed by OMB or the
6 like, these should be identified and an effort made to address them
7 consistent with this recommendation.

8 **Comments on Possible Unintended Consequences**

9 One of the inherent challenges in any public policy is that there are few
10 choices that make everyone better off. The political and policy worlds
11 necessarily involve tradeoffs. This is obvious in the dairy sector even among
12 producers and certainly becomes an increasingly difficult issue when bringing
13 in perspectives of dairy processors, retailers, consumers, taxpayers, or
14 alternative agricultural or food sectors. The charge to this committee has
15 been specified in terms of dairy farm profitability and milk price volatility.
16 This puts the focus on the farm sector, but it is surely the case that
17 considerations of downstream effects enter and constrain any dairy policy
18 debate.

19 The specific topics of dairy farm profitability and milk price volatility
20 continue to be studied by the DIAC. The recommendations presented here
21 are framed from the perspective of the DIAC charge. We recognize that the
22 Secretary has a responsibility to balance and represent a public interest in
23 the administration of USDA programs and acknowledge that achieving that
24 balance is a difficult task. It is simply unavoidable that programs aimed at
25 assisting farmers by improving their price can be viewed as constraining



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1 sales and even as being contrary to the interests of consumers. In this
2 regard we would simply state that price stabilization programs that do not
3 significantly impact average price levels can arguably have salutary affects
4 for both buyers and sellers. Moreover, it is a premise of these
5 recommendations that low price movements of the recent past, while
6 arguable market driven, reached levels that cannot be satisfactorily
7 explained as being the result of perfectly competitive markets. The purpose
8 of the policies discussed here are not to eliminate by government fiat price
9 disciplines that are consistent with market conditions, but rather to consider
10 how price changes can be moderated when they are judged to be excessive.

DRAFT