



Agricultural Issues Center
University of California

July 2007

The Farm Bill and California Dairy

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Supported in part by the Agricultural Marketing Resource Center



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The main dairy provisions of the Farm Bill are typically included in a section of Title I, the Commodity title. Dairy is treated separately from the general crop provision and a number of specialized policies apply only to the dairy industry. Public policy plays a larger role in U.S. dairy markets than perhaps any other agricultural market. Central elements of dairy policy date back to the New Deal farm legislation of the 1930s, and although the original programs have evolved over time, they remain largely unchanged in their main economic implications as new programs have been added.

Dairy policy is particularly important to California. Dairy producers, consumers, and the rural economy and environment all have a stake in federal dairy policy. Farm sales of milk in California were \$4.5 billion in 2006, making dairy by far the largest agricultural industry in California, accounting for about 14 percent of agricultural value in the state. About 1.8 million dairy cows produced 38.8 billion pounds of milk in 2006. Nearly half of the milk produced in California is processed into cheese and about 10 percent of the milk fat and about 20 percent of the non-fat solid is used for fresh beverage milk.

California is by far the largest dairy producer in the United States, accounting for about 21 percent of all the milk produced in the United States (Table 1). Table 1 also shows that California dairy

prices are typically below the national average and below those in other major dairy states. In part, this reflects the productivity of dairy farms in California and federal regulations that reduce the ability of California dairies to compete openly in national markets. California is also the nation's largest producer of cheese, nonfat dry milk, and ice cream. California dairy products are shipped to the rest of the United States and, increasingly, to export markets.

Dairy support policy includes four main elements. The first is a legislated price support for milk that is implemented by government purchases of butter, non-fat dry milk, and American cheese. Second, as introduced by the 2002 Farm Bill, dairy farmers receive payments under the Milk Income Loss Contract (MILC) program when the price of milk falls below a legislated benchmark. Third, payments to exporters subsidize exports under the Dairy Export Incentive Program (DEIP). Annual government outlays for these three programs averaged \$1.6 billion from 2000-2007, and \$744 million from 2002-2007 (Figure 1), with most of that allocated to the price support and MILC. Finally, Federal (and California) milk marketing order provisions limit regional movement of fresh milk, set minimum prices depending on region and end use, and mandate revenue pooling among farms. Not all the programs originated with the Farm Bill, but all of these dairy program provisions are subject to modification under the 2007 Farm Bill.

*This AIC Farm Bill brief is one of a series that provides information on the 2007 Farm Bill of particular relevance for California. For more information and references to additional analysis please check www.aic.ucdavis.edu.

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Dairy Policies and Consequences

The Milk Price Support Program

The support price of milk gradually declined throughout the 1980s and 1990s and the program was scheduled to end by 1999. The end of the program was first postponed and then abandoned in the 2002 Farm Bill, but the support price for milk has remained at \$9.90 per hundredweight of milk, well below average market prices. Nonetheless, government purchases of wholesale butter, non-fat dry milk, and cheese have occasionally occurred in recent years. Outlays for government purchases average \$410 million per year (about 2 percent of milk revenue) during years 2000-2003. In times of very low prices, government purchases prevent prices from falling further than they otherwise would, and thereby increase production of supported products. Benefits to dairy farms, in the form of higher prices, come partly at the expense of consumers, who face higher prices for dairy products and partly at the expense of taxpayers who pay for the accumulation of stocks that typically must be liquidated at a loss. The taxpayer and consumer costs of the price support exceed the benefits to dairy farms, generating a small net loss to the U.S. economy.

The price support also distorts dairy markets in ways that harm long-run productivity and competitiveness. Support for selected standardized products reduces product innovation as U.S. dairy manufacturers continue to produce the bulk commodities supported by the policy. Partly as a result, U.S. dairy lags major exporting regions (such as Australia and New Zealand) in the development of high-value dairy ingredients, such as concentrated milk protein, where growth opportunities exist. The price support also poses an obstacle to successful multilateral trade negotiations. Despite modest benefits to U.S. dairy farmers, the dairy price support accounts for more than 20 percent of

the U.S. Aggregate Measure of Support (used by the WTO as a measure of trade-distorting farm policies)—more than any other commodity. Success in negotiating market access and subsidy reduction in other countries is limited by a need to protect the U.S. milk price support.

Milk Income Loss Contracts

The Milk Income Loss Contract (MILC) payments are triggered in months when milk prices are low, and are made on current monthly production up to a quantity limit per farm of 2.4 million pounds per year (the annual output of about 100 cows in California). Over the period FY2003-2005, the MILC cost taxpayers about \$2.0 billion. Besides transferring income from taxpayers to dairy farmers, these payments tend to stimulate aggregate milk production and maintain production in high-cost regions on smaller, higher-cost farms.

MILC payments can be an important source of revenue for smaller farms which are common in the Midwest and East because of the cap on quantity eligible per farm. During FY2003-2005, MILC payments were the equivalent of 1 percent of milk revenue on California farms, compared to more than 4 percent of milk revenue in the Upper Midwest and even more in New England, where average herd size is less than one tenth that of a typical California dairy farm. Indeed, MILC payments actually reduce incomes for typical California dairy farms and other large farms that account for 60 percent of the U.S. milk production. For larger farms, the lost market revenue due to lower milk prices exceeds the MILC payment. The MILC program acts as a regional redistribution policy to the detriment of dairy farms in the West, including California. It also raises average costs of production and reduces the competitiveness of the aggregate U.S. dairy industry.

Dairy Export Programs

The dairy export program is a small residual of much more widespread and larger export subsidy efforts that the United States pursued in the late 1980s and early 1990s. The dairy export program has been used for non-fat dry milk, but more recently the United States has been a commercial exporter of non-fat dry milk without recourse to subsidy. As a part of its WTO proposals, the United States pledged to remove all agricultural export subsidies as soon as other countries (mainly the E.U.) agreed to remove their analogous programs. Such mutual subsidy elimination was scheduled to occur in 2013.

Milk Marketing Orders

In 2005, the federal and California milk marketing orders together regulated the sale of 87 percent of U.S. milk production. Marketing orders raise the average producer price of milk by enforcing minimum prices for milk used in fluid and soft products (e.g. beverage milk, ice cream, and yogurt). The diversion of milk to other uses reduces the prices of milk powder, butter, and cheese. The costs to consumers—through higher prices for fluid milk and other dairy products—exceed farmer benefits. Federal milk marketing regulations also harm dairy farms in low-cost regions. Milk prices in low-cost regions, including California, are kept artificially low by marketing order regulations that reduce prices for milk powder, butter, and cheese and stimulate production in high-cost regions such as the South and the Northeast. Although marketing orders sometimes have been changed through a regulatory process and in interim legislation, rather than in previous Farm Bills, the 2007 Farm Bill can be used to modify federal milk marketing orders.

California Dairy and the 2007 Farm Bill

California dairy producers and consumers have much at stake in the 2007 Farm Bill. We have highlighted commodity and Trade title issues. Given the growth in the commercial export potential for California dairy products, international trade provisions are also important. The California dairy industry also has a stake in assuring that farm subsidy provisions in the Farm Bill for all commodities do not stand in the way of improving market access through international negotiations.

The dairy industry has strong interest in the Nutrition title, especially potential changes in school milk programs, the Women, Infants and Children (WIC) program, and provisions related to nutrition information and education. All of these programs help stimulate the demand for milk and build the market for the future. The Conservation title of the Farm Bill also has important potential consequences for California dairy and the California environment. Producers here face more stringent environmental standards than other dairy farmers in the United States. Farm Bill conservation programs can help dairy farmers meet these standards with cost sharing and programs that pay producers to undertake environmentally friendly practices. Funding for these programs has been severely limited in the past and has not targeted large-scale dairy farms, even though the environmental benefits from improved practices can be substantial. The Energy title of the Farm Bill also has important potential implications for the dairy industry. California dairy farms are major users of feed grains, oilseeds, silage, and hay. The prices of all these feeds have jumped in 2007 with the boom in ethanol demand. A Farm Bill that focuses increased subsidy on the use of agricultural feedstock for fuel will drive feed prices even higher. The California dairy industry is well

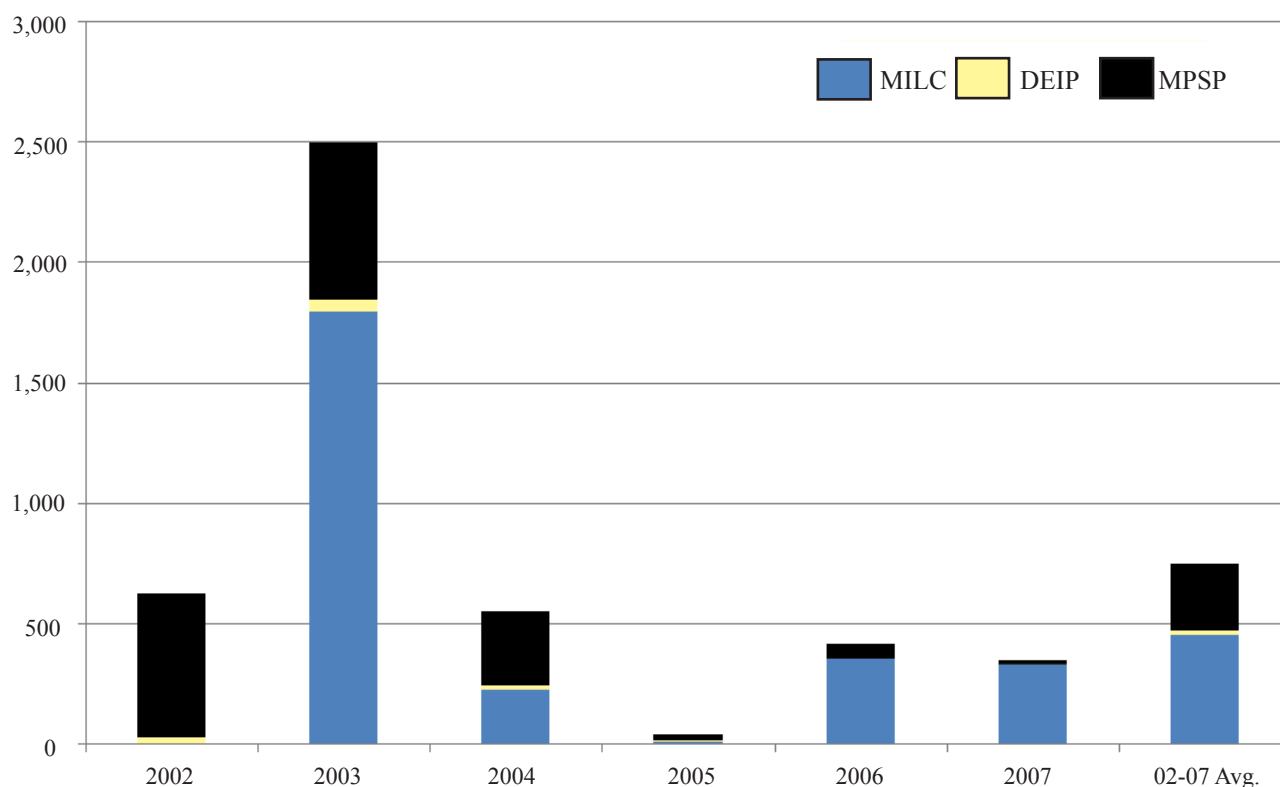
positioned to compete for inputs with commercial energy demands, but is severely affected by competition with government subsidies that shift agricultural resources away from feed uses and towards fuel. Finally, given the importance of productivity growth and innovation to the California dairy industry, a strong Research title of the Farm Bill that provides adequate support and flexibility is vital to the long-term health of the industry and its ability to contribute to the California economy.

Table 1. Milk Production and Prices, Top Dairy States and United States

State	Milk Production (billion pounds)	Share of National Total (percent)	2005 Average All Milk Price (\$/hundredweight)
California	38.8	21	13.92
Wisconsin	23.4	13	15.60
New York	12.0	7	15.90
Idaho	10.9	6	14.00
Pennsylvania	10.7	6	16.90
U.S. total (average)	181.8	100	15.20

Source: NASS, USDA.

Figure 1. USDA Outlays for Dairy Price Support, MILC, and DEIP, FY 2002-07 (\$ million)



Source: USDA-FSA, CCC History of Budget Expenditures—Book 4, accessed online at <http://www.fsa.usda.gov/FSA/webapp?area=about&subject=landing&topic=bap-bu>