# Future U.S. Dairy Policy: The Next Farm Bill

Robert Cropp

Department of Agricultural and Applied Economics, 229 Taylor Hall, University of Wisconsin, Madison, Wisconsin 53706
Email: cropp@aae.wisc.edu

## ■ Take Home Message

For better than 50 years two federal programs have impacted farm level milk prices, the federal dairy price support program, which is national in scope, and federal milk marketing orders, which are voluntary and apply to about 70% of U.S Grade A milk supply. The two programs work together to provide some price stability and to enhance farm level milk prices. The federal dairy price support program has changed dramatically beginning in the 1980s, and under the 1996 Farm Bill, it is scheduled to terminate. The existing federal support program currently provides a very limited safety net for farm milk prices. Market forces determine farm level milk prices most of the time. Minimum dairy farmer pay prices established under federal milk marketing orders are influenced by the federal dairy price support program. But federal orders have not changed significantly since the 1960s. Federal order pricing provisions have not kept up with major changes in the structure of the U.S. dairy industry. Regions of the U.S are impacted quite differently by federal orders. California, the leading dairy state is not part of the federal order system.

Federal orders should not be a part of Farm Bill debates. But since 1985, they have been included in farm policy debates. Further, since regions of the country that are relatively high fluid use markets (beverage milk) benefit more from federal orders than primarily manufacturing use markets and because farm milk prices are currently depressed consideration will be given to changes in the federal dairy price support program that would benefit these manufacturing use markets. Finally, there will be push for extending and expanding regional dairy compacts as a means to isolate farm level milk prices from any changes in either the federal support program or federal milk marketing order that would lower the safety net to dairy farmers. In summary, the 2002 Farm Bill will provide some form of safety net for dairy farmer but relatively high support prices and rigid supply controls are not likely. A continuation of the existing support program or some type of a target price deficiency payment program appear to be the most likely alternatives for the 2002 Farm Bill.

## ■ Brief Review of U.S. Dairy Policy:

The formal dairy price support was authorized under the Agricultural Adjustment Act of 1949. Initially, the level of support was based on a parity formula. The dairy industry experienced a growing milk surplus situation in the late 1970's. As a result, in 1981 a major change was made in the support program. The use of a parity formula was terminated and replaced with U.S. Congressional determination of the support level based on the level of milk surpluses and government costs. The support price was $13.10 per hundredweight in 1981. Due to continued growing milk surpluses, the 1982 Omnibus Budget Reconciliation Act established producer assessments on every hundredweight of milk marketed by farmers to defray some of the associated government costs. The 1983 Dairy and Tobacco Adjustment Act lowered the support price to $12.60 and established the Dairy Diversion Program. This was a voluntary supply management program that paid dairy producers $10 per hundredweight for reductions in milk marketings from a base over a period of 15 months. To address the demand side a mandatory 15 cents per hundredweight check-off on all milk marketed by dairy farmers for the purpose of dairy product promotion, research and dairy nutrition was established. Nevertheless, burdensome milk surpluses continued. The Food Security Act of 1985 resulted in further reductions in the support level and implemented the Dairy Termination Program. This program accepted bids from dairy farmers to slaughter or export their dairy cattle and to cease using their dairy facilities for a period of 5 years. The Act also increased Class I differentials in federal orders in the southern and northern markets, the first major change since the 1960s.[1]

The 1990 Food, Agriculture, Conservation and Trade Act moved the dairy industry further towards market orientation by establishing the support price at $10.10. The Act also instructed the Secretary of Agriculture to hold a national hearing on Class I milk pricing under federal orders. A hearing was held but little change occurred with federal order Class I pricing provisions. As a result, the primarily manufacturing milk use regions, mainly the Upper Midwest region, were not pleased with no changes. They charged that the Class I differentials which increase from the Upper Midwest to the other regions of the country were no longer justified due to modern milk production, processing and marketing technologies. These higher Class I differentials were encouraging surplus milk production and thereby depressing the price of milk used for manufacturing purposes. Since the hearing the Upper Midwest sued the U.S. Secretary of Agriculture charging that he has neglected his responsibility as required by federal order legislation to change federal milk marketing orders to correspond with the changes in the dairy industry. The Upper Midwest lost the lawsuit

[1] Federal milk marketing orders establish minimum producer pay prices for milk based on how it is used called classes. Class I is milk used for fluid (beverage) purposes and is set higher than milk used to make manufactured dairy products by adding a differential to a base manufacturing milk price.

partially because the debate going on for the next farm bill included possible changes in federal orders. The next farm bill was the 1996 Federal Agriculture Improvement and Reform Act. The Act continued the market orientation approach by phasing down the support level over 4 years from an initial $10.35 per hundredweight down to $9.90 and terminating the support program the end of 1999. At this time the support program would be replaced with a recourse loan program on dairy products for dairy manufactures. Assessments against dairy producers were terminated. The Secretary of Agriculture was directed to consolidate the number of existing 31 federal milk marketing orders to no less than 10 and no more than 14 and to study pricing provisions of orders with implementation of consolidation and any pricing changes by April 1999. The Act also authorized the Secretary to establish a Northeast Dairy Compact up until federal order reform was implemented. But agricultural appropriation bills delayed implementation of federal order reform until January 1, 2000, extended the support price at $9.90 for both 2000 and 2001 and extended the Northeast Dairy Compact until September 30, 2001.

Not only did U.S. Congress delay implementation of federal order reform until January 1,2000, it instructed the Secretary of Agriculture to review the component pricing formulas used to establish the minimum class prices. The Secretary was instructed to implement any changes by January 1, 2001. The Secretary held a hearing in May 2000 for this very purpose and issued a tentative final decision that was implemented January 1, 2001. The industry could comment on these tentative changes until February 5, 2001. The Secretary will review these comments and issue a final decision upon which implementation will require approval by dairy farmers.

An understanding of the current issues with federal milk marketing orders is important in understanding dairy policy for the 2002 Farm Bill. Two major changes did occur with the federal order reform implemented on January 1, 2000. First, the base milk price used as the mover of federal order class prices was drastically changed. For about 40 years the price paid to farmers for Grade B milk by butter, milk powder and cheese plants in Minnesota and Wisconsin was used as the mover. From the early 1960s until 1995 this pay price was referred to as the Minnesota Wisconsin Price (MW) and then the Basic Formula Price (BFP) until January 1, 2000. The BFP was replaced with a component pricing formula for milk used in cheese, called Class III. For Class III a price per pound of butterfat is calculated from the price of butter, the price of protein per pound from the price of cheese with consideration for the butterfat value and a price per pound of solids not butterfat or protein from the price of dry whey. The Class III price per hundredweight of milk is derived by multiplying these three milk component values by the pounds of these components in 100 pounds of milk and adding up these values. A Class IV price, milk used to make nonfat dry milk and butter is also component driven. The price per pound of solids not fat is derived off of the price of nonfat dry milk and the price per pound of butterfat from the price of butter. The hundredweight value of Class IV is

computed by the sum of multiplying the price per pound of nonfat solids and the price per pound of butterfat by their respective pounds in 100 pounds of milk. Class II is milk used to make soft manufactured dairy products like ice cream and yogurt. Its price is based off of the Class IV skim milk price plus a differential of $0.70 per hundredweight and adding the class IV butterfat value.

The second major change was the establishment of an entirely different Class I mover. Rather than using a mover like the BFP, the mover was changed to the higher of an advanced Class IV or advanced Class III skim milk price. This change in the Class I mover has resulted in significant differences in how dairy farmers have been impacted regionally by surplus milk production. The advanced Class IV skim milk price averaged $1.80 per hundred weight higher during 2000, with a difference as great as $3.61, than the advanced Class III skim milk price (Table 1). The reason for this is the federal support price on nonfat dry milk is relatively higher than the support price on cheese. Nonfat dry milk was in surplus all year and therefore its price was at support. Cheese prices were depressed and either close to or below support. As result, the Class I milk price was moved by the advanced Class IV skim milk price all year. Dairy farmers in regions of relatively high Class I usage in essence were partially protected from the surplus milk situation. Where before the price of cheese was a major factor in the BFP and the mover of Class I, the Class I price was de-coupled from cheese prices. Under this new pricing arrangement dairy farmers in different regions of the country are receiving different price signals as to the supply and demand situation for milk. Dairy farmers in the dominantly fluid use markets have not experienced the same decline in milk prices as have dairy farmers in the dominant manufacturing use markets, like the Upper Midwest and portions of the West. Further, as table 1 shows not only were Class I prices higher with the Class IV skim milk price as the mover but also Class I prices were quite stable since nonfat dry milk prices were at support all year. Consequently the Upper Midwest continues to be unhappy with federal order pricing provisions and will no doubt continue to push for change in the 2002 Farm Bill.

**Table 1: Class IV and Class III Skim Milk Prices Per HundredweightUnder Federal Milk Market Orders, 2000**

| Month | Class IV Skim Milk Value ($s) | Class III Skim Milk Value ($s) | Difference between Class IV and Class III ($s) |
|---|---|---|---|
| **Jan** | 7.73 | 6.57 | 1.16 |
| **Feb** | 7.72 | 7.23 | 0.48 |
| **Mar** | 7.71 | 6.43 | 1.27 |
| **Apr** | 7.70 | 6.25 | 1.46 |
| **May** | 7.70 | 5.58 | 2.12 |
| **Jun** | 7.70 | 5.29 | 2.41 |
| **Jul** | 7.71 | 4.02 | 3.68 |
| **Aug** | 7.70 | 6.43 | 1.27 |
| **Sep** | 7.70 | 6.14 | 1.56 |
| **Oct** | 7.76 | 6.66 | 1.10 |
| **Nov** | 7.74 | 6.30 | 1.44 |
| **Dec** | 7.75 | 4.14 | 3.61 |
| **Average** | 7.72 | 5.92 | 1.80 |

Further, the problem of the higher of the advanced Class IV or advanced Class III skim milk values as the mover of Class I prices could be partially solved by "tilting" the support price from nonfat dry milk (lowering it) to butter (raising it). Once the support price per hundredweight of milk is established a Commodity Credit Corporation (CCC) purchase price per pound is established for butter, nonfat dry milk and cheddar cheese. Since butter and nonfat dry milk are joint products made from a 100 pounds of milk there is discretion on the part of the Secretary of Agriculture in deciding the CCC purchase price for nonfat dry milk and butter as long as the combination of these prices equal the value of the support price per hundredweight. The guideline the Secretary is to follow is to set these purchase prices at a level that will minimize government costs of the support program but yet achieve its objective.

Under the 1990 Farm Bill there was a major surplus of butter. To reduce government costs the support price on butter was reduced from $1.0925 per pound to $0.65 per pound and the purchase price of nonfat dry milk raised from $0.79 per pound to $1.03 per pound. The industry responded by reducing butter production and using the butterfat in higher use dairy and food products. Now the situation is reversed with butter prices remaining well above support level, but nonfat dry milk as a major surplus product. Further, imported milk protein are lower in value than domestic nonfat dry milk and are being used in place of nonfat dry milk to make cheese, other dairy products and used in various other food products. As result, there is interest on part of the dairy industry to tilt the support price from nonfat dry milk to butter to encourage more domestic use of nonfat dry milk and to reduce the cost of the dairy price support program. But

this would also lower the nonfat dry milk price which in turn would lower the skim value of Class IV milk. Since Class IV has been the mover of Class I prices, this tilt would lower Class I milk prices. As a result, the dominant fluid milk use regions are greatly opposed to the tilt. But recognizing that dairy farmers in the dominant manufacturing use markets are experiencing very low milk prices because of surplus milk and low cheese prices there is some support to target some dairy support program benefits to Class III use markets. In fact, legislation is being drafted a head of the 2002 Farm Bill to be implemented in 2001 that would establish a target price for Class III milk. If market prices fell below this target dairy producers would receive the difference in the form of a deficiency payment. I will discuss this alternative in more detail later. But all of this is mentioned here to help understand the relationship between the federal dairy price support program and federal milk marketing orders and why both enter into the dairy policy debate. It also illustrates why there are major regional differences in opinion as to a national federal dairy policy.

## ■ The Current Dairy Environment:

The 1996 Farm Bill was titled the “Freedom to Farm” bill. The intent was to reduce government involvement in production decisions of crop farmers and to reduce government price and income support. The tone was a move to greater market orientation and international competitiveness. Crop farmers had the freedom to plant what ever crop they choose without losing eligibility for farm programs. But excellent crops and a sluggish export market resulted in low grain and soybean prices. U.S. Congress each of the past three years passed emergency budget appropriations to subsidize crop farmers for low commodity prices. Low commodity prices along with relatively good milk prices greatly improved the milk-feed price ratio. The U.S. dairy industry experienced an average milk price of $13.34 per hundredweight for 1997, a record $15.50 per hundredweight for 1998 and $14.36 for 1999. The 5-year average milk price was $14.09 per hundredweight. Dairy farmers responded to these relatively good milk prices and relatively cheap feed by expanding the U.S. dairy herd.

While milk cow numbers normally decline about 1 percent a year, milk cow numbers increased slightly during 1999 and continued to increase every month during 2000 averaging about 1 percent higher than the previous year. Milk per cow normally increases annually about 2.2 percent. But adverse weather during 1998 slowed the increase to just 1.9 percent. Milk per cow recovered during 1999 to an increase of 3.3 percent and weather was ideal during 2000 resulting in another 2.9 percent increase in milk per cow. The net result of these cow numbers and milk per cow was an increase in total milk production of just 0.8% for 1998. With excellent commercial sales, increasing 2.4 percent, record farm level milk prices were set during 1998. Although milk production increased 3.4 percent during 1999, the strong increase was during the second half of the year

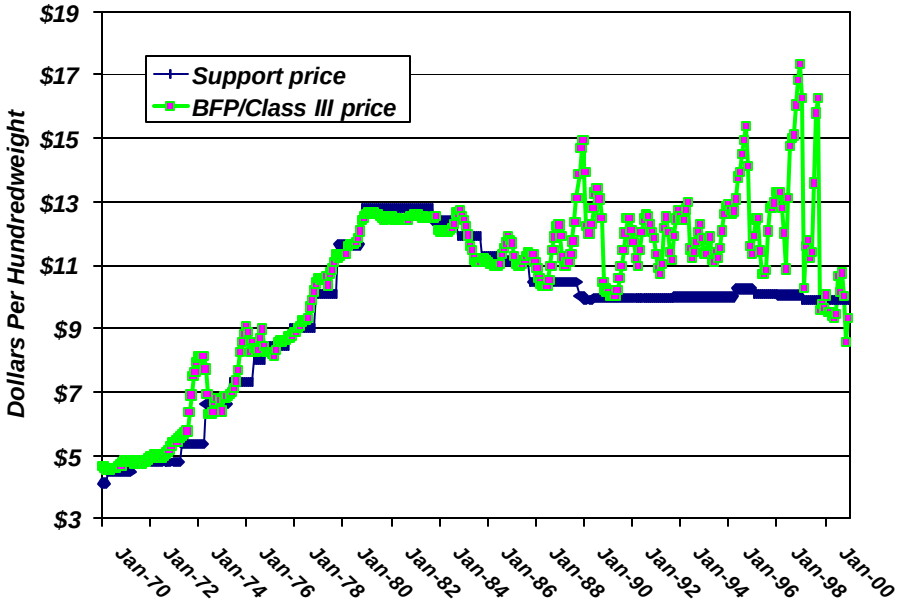
and wholesalers maintained strong buying up until late August which kept wholesale cheese and butter rather high. The result was a record September milk price and an above 5-year average milk price for the year. With expansion decisions in the works and relatively cheap feed prices supporting still a favorable milk-feed price ratio milk cow numbers increased throughout 2000. Total milk production was up another 3.6 percent during 2000 surpassing a 3.0 percent increase in commercial sales. Cheese stocks grew to well above year ago levels and the 5-year average. The result has been very depressed milk prices. The Class III price drop to just $8.57 per hundredweight in November, the lowest milk price since June of 1977. The average milk price for the year was just $12.30 per hundredweight, well below the $14.09 per hundredweight 5-year average. But as indicated above, dairy farmers in the manufacturing use milk regions experienced even much lower milk prices than did dairy farmers in the fluid use markets. In response to these low milk prices the U.S. Congress also approved payments to dairy farmers to offset some of the impact from low milk prices. So in essence the Freedom to Farm Bill never was implemented. Government payments to farmers surpassed $28 billion for 2000, close to a record expenditure. These government payments equal approximately 40 percent of net farm income.

This background is useful to understanding dairy policy for the 2002 Farm Bill. First, U.S. Congress is getting tired of each year considering special budget appropriation bills to bail out farmers because of low commodity prices. Second, it realized that by bailing out crop farmers due to low commodity prices it has kept crop production at high levels and continued depressed crop prices. These depressed crop prices keep feed prices low to dairy farmers encouraging additional milk production and low milk prices. Without question, the Freedom to Farm provisions of the 1996 Farm Bill will be closely examined for grain crops, soybeans and other commodities. This enhances the possibility of a continuation of a support program for dairy. If dairy was the only commodity experiencing low prices, the chance of getting something just for dairy would not be as great. Thus, it is very unlikely that the federal dairy price support program will terminate. It very likely will experience some changes but not be terminated.

There is also a major concern with what is happening to the dairy farm structure. There is a strong trend towards fewer and larger dairy operations. In 1990, there were a total of 193,790 farms that had milk cows. This number decreased by 42.6 percent to 111,220 farms in 1999. That is an annual decline of nearly 5 percent. A continuation of this trend, if not accelerating, is forecasted for the next 5 years. This has brought on discussions of targeting federal dairy price support programs to smaller dairy farmers. The recent payments to dairy farmers for low milk prices just mentioned had a payment limit of 39,000 hundredweights of annual milk production, a dairy farm of about 200 or fewer cows.

In summary, the market oriented federal dairy policy of the 1990s have brought with it very uncertain and volatile dairy product and farm level milk prices. Prior to this policy change, the federal dairy price support program enhanced farm level milk prices and provided price protection to dairy farmers (see Chart 1). But with a support price currently at $9.90 per hundredweight, a price below the cost of production for most dairy farmers, market forces and not federal programs determine dairy product and farm level milk prices most of the time. In fact, due to mechanics of the CCC purchase program and the extent of the milk surplus situation, as can be seen in chart 1, the Class III milk price actually fell below support during some months of 2000. This price volatility brought on dairy futures and options as price risk management tools in 1993. The 1996 Farm Bill also provided for government assistance for educational programs to help dairy farmers learn how to use dairy options to protect milk prices. This is the Pilot Dairy Options Program. U.S. Congress also approved in 2000 a 5-year program to make it more feasible for dairy plants regulated under federal milk marketing orders to offer dairy farmers cash forward milk contracts. But few dairy farmers have responded to using these tools. Despite the availability of these price risk management tools, there will be pressure for the federal government to return to providing a greater level of price protection to dairy farmers. This, however, provides a degree of conflict. On the one hand the government is subsidizing the use of price risk management tools for dairy farmers to manage their own price risk. But if the government reverts back to greater price protection for dairy farmers, the need for and the possible success of these price risk management tools is greatly reduced.

***Chart 1: BFP or Class III Milk Price versus the Support Price, 1970-2000***



## ■ Dairy Policy Provisions of the 2002 Farm Bill:

The major issues entering the 2002 Farm Bill debate are: 1) milk price uncertainty and volatility, 2) low milk prices, 3) loss of family dairy farms, 3) level of support on butter and nonfat dry milk, 4) regional disparities in pricing provisions of federal milk marketing orders, 5) regulation of imported ultra-filtered milk and milk proteins, and 6) the continuation and expansion of dairy compacts. Because of these concerns, the elimination of any type of federal dairy price or income support program is not likely to happen. However, there are a number of dairy farmers, mainly larger and more progressive dairy farmers who favor elimination of any type of dairy support program. They like managing on their own the volatility of milk prices and taking advantage when the opportunity dose arise to lock in relatively favorable milk prices via dairy futures, dairy options or cash forward contracts with a milk buyer.

There is a good possibility that the existing federal dairy support program will be continued at the existing or perhaps a little higher price support level. The current support price could be continued at $9.90 per hundredweight or perhaps increased to something less than $11.00 per hundredweight. The CCC would then purchase butter, nonfat dry milk and cheese at prices that would support this level of milk prices. Under normal conditions the Class III milk prices would average in the $11.25 to $11.75 range. So a support price less than $11.00 would still allow the markets to determine milk prices most of the time.

But there is interest on the part of some dairy farmers and farm organizations to set the support price considerably higher than $11.00 per hundredweight, perhaps in the range of $12.50 to $13.00 range. Unless adverse weather disrupts milk production a support price at these levels would be the effective milk price most of the time. The larger and modern dairy operations are willing to produce milk at prices near $12.00 per hundredweight or even lower. Most agricultural lenders will provide financing for new dairy operations or expansions if they will cash flow at $12.00 to $12.50 per hundredweight. So support prices at these levels would result in a major milk surplus and high associated government costs. Of course if feed prices would take a major increase, this would reduce the milk surplus potential. But with interest on part of the U.S. to be competitive in the export markets for grain and oil seed crops it is not likely that 2002 Farm Bill provisions will substantially increase the prices of these commodities and feed costs to dairy farmers.

Some type of supply control is once again being tossed around. A higher level of price support without enhancing government costs to unacceptable levels is feasible with supply control. Supply controls for dairy have been proposed as federal policy since the 1980s but not with much success. The alternative has been to reduce the level of support and let market prices correct any supply and demand imbalances. The exception has been limited use of producer

assessments refundable to dairy farmers who did not increase milk production, direct payments to dairy farmers who reduced their milk marketings, or the payment to dairy farmers to quit dairying for a period of time and to slaughter or export all female dairy animals. These programs had limited success because they were voluntary and only operated for a short period of time.

While there is again much talk about supply management I do not see a great possibility for having a relatively high support price on milk and a rigid mandatory supply management program. Major resistance to supply management has always surfaced from those producers who desire to increase their dairy operations or from those who wish to enter the business of farming. Further dairy farming has been a long tradition of certain regions of the U.S. like the Upper Midwest and the Northeast. These regions are heavily characterized by smaller and more outdate dairy operations. While these smaller dairy farmers may strongly favor a supply management program, programs have been developed at the state level to provide assistance to dairy farmers considering expansion or new dairy operations. Wisconsin, Minnesota and Iowa each have programs to assist with dairy development. It is fully recognized that unless new investments are made in the dairy farm segment of the industry the region will not be competitive with the growing and more modern dairy industry in the West. While there is currently a milk surplus this situation will eventually improve. Commercial sales continue to grow, much of which is from increased cheese sales. Cheese plants in the Upper Midwest need more milk to make cheese in order to satisfy there growing customer needs. If milk production does not increase in the Upper Midwest customers will seek needed supplies elsewhere. So any supply management program that discourages dairy development will face stiff objections in some circles of the industry. Therefore, I give a very low probability of relatively high support prices and a mandatory supply management program occurring. Some form of voluntary supply management like produce payments for not increasing milk production has some possibility for inclusion in the 2002 Farm Bill.

A major change in the dairy support program from a support price supported by CCC purchases of manufactured dairy products to a target price deficiency payment program has a real possibility of being implemented. There are four major reasons for this possibility. For one, it still allows the markets to work in setting dairy product and farm level milk prices. Second, it puts dairy policy in the same fashion as grains and oilseeds policy that have used target prices and deficiency payments. And finally, deficiency payments may be targeted to smaller dairy farms. But target prices and deficiency payments can run into the same problem as high support prices. That is encouraging too much milk production without a supply management program tied to it. The only difference is that under a target price deficiency payment dairy product prices are allowed to fall to levels that will clear the market. There are no increased government costs from large purchases of surplus dairy products. But without payment

limitations government costs associated with deficiency payments could also become unacceptable.

Another problem with a target price and deficiency program is what price to use as the target price. As indicated above, not all regions of the country experience the same changes in farm pay prices due to federal order pricing provisions. And in California and other parts of the country and for some milk plants that are not part of the federal order pricing system milk prices behave yet differently. Further, the Northeast has a dairy compact that already isolates dairy farmers in that region from some of these low milk prices. U.S. does not have a uniform milk pricing system across the country. This makes the implementation of a target price deficiency payment program more difficult.

Current discussion has centered around a target price for Class III milk. The reasoning behind this centers around the federal milk marketing order higher of an advanced Class IV or advanced Class III pricing provision for Class I milk and the nonfat dry milk and butter price tilt discussed above. Relatively high fluid use regions are strongly opposed to anything that would reduce Class I prices such as a tilt from the nonfat dry milk price to the butter price or the change in the higher of mover for Class I prices. But these same regions also realize the inequities this has created for dairy farmers in manufacturing use markets and their interest in pursuing changing the Class I mover and/or doing the tilt. With a target price on Class III and total dollars made available for deficiency payments to dairy farmers being based on the utilization of their milk as Class III, the manufacturing use markets would receive the major share of the deficiency payments. Such a provision may influence the Upper Midwest to back off from pursuing changes in federal orders. This approach may also be more equitable but not without its problems. Provisions will need to be made to include California that is not under the federal order system and a number of producers who sell their milk to cheese plants not regulated under an order or producers of Grade B milk which also is not regulated under an order. Hence major legislative changes will be required to implement this program.

Another slant on a target price deficiency payment program would be to establish a target price, but if the market price falls below the target price, only those dairy farmers who had not increased milk production would be eligible for deficiency payments. This would be similar to the grains program used in the past where farmers had to set aside a percentage of their acreage in order to qualify for deficiency payments. However, it is more difficult for dairy because it is not as easy to plan for a specific reduction in milk production as it is to set aside a percentage of ones acreage.

Despite these problems next to continuation of an existing dairy price support program a version of a target price deficiency payment has a good possibility for dairy in the 2002 Farm Bill.

Another new approach that may be considered is the concept of a whole farm revenue or margin safety net. A whole farm revenue program would protect dairy farm revenue at some percentage of a 5-year Olympic average (a 5 year average by eliminating the high and low years) of gross farm income. Another approach would be to protect a profit margin by some index measure of the relationship between milk prices and feed prices. To offset government cost of these approaches dairy farmers who wish to participate would be required to pay some type of insurance premium to cover a portion of the program cost. Both approaches would allow market forces to determine dairy product and farm level milk prices. Dairy farmers would be protected from low milk prices via of payments to offset part of their loss in gross farm income or reduced margins from producing milk. Diversified farmers may receive payments for reduced gross farm income resulting from a combination of lower milk and/or grain prices, for example.

U.S. Congress has requested USDA to study the use of and impact of imported ultra-filter milk and milk proteins on the U.S. dairy industry. Based on this report U.S. Congress may attempt to legislate restrictions on the import of or the use of these products in the making of cheese and other dairy products. However, such action is contrary to U.S. expressed interest in reducing restrictions on international trade of dairy products.

Related to this issue is the support price on nonfat dry milk versus butter. If the CCC purchase type of dairy price support program is continued, then the issue of the proper support price for nonfat dry milk versus butter is relevant. As already mentioned nonfat dry milk remains at support level and burdensome government stocks of surplus nonfat dry milk exist. Reducing the CCC purchase price on nonfat dry milk and increasing it on butter has real logic for three reasons. First, a lower price for nonfat dry milk would likely increase its use in domestic dairy and food products. Second, a lower nonfat dry milk price may reduce the import of lower priced ultra-filtered milk and milk proteins that are replacing nonfat dry milk. Third, the government cost for the federal dairy price support program would be reduced. Fourth, a higher CCC purchase price would add some stability to a very volatile butter price. With a higher floor price under butter, butter makers and wholesalers may be willing to carry larger quantities of butter stocks. Now butter stocks are relatively tight and slight changes in butter supplies or anticipated butter supplies results in relatively large and quick changes in butter prices. This price changes expose those who hold butter stocks to a great deal of price risk from changing stock values. But, as indicated earlier a lower nonfat dry milk price would lower the Class IV price and in turn a lower Class I price would result. Thus, this change will come with major resistance from high fluid use markets in the Southeast and Northeast. These two regions also have a lot of political power.

Finally, there will be attempts to include in the 2002 Farm Bill the right to continue and expand dairy compacts. The 1996 Farm Bill for the first time

authorized a dairy compact for six New England states until federal order reform was implemented. Federal order reform was implemented on January 1,2000, but strong political power in the Northeast with support from the Southeast was successful in extending the Northeast Dairy Compact until September 30, 2001. Political activity is already underway to get an extension of the Northeast Dairy Compact beyond the September 30, 2001 date and to expand the authority of compacts to other regions. What these dairy compacts do is allow a committee of producers with consumer representation to establish a price for Class I milk at a relatively high level. If this established price is higher than the minimum federal order Class I price, then the compact Class I price prevails. The effect is to stabilize prices paid to dairy farmers for milk used as Class I at a higher level than what would likely exist without the compact. Consumers in the compact area pay a higher price for beverage milk as a result. Any fluid milk entering from outside the compact area must also pay this higher compact price. In 2000 with depressed milk prices the Northeast Dairy Compact resulted in significant additional revenue being paid to compact dairy farmers. Hence, dairy compacts de-couple Class I milk from supply and demand forces in the market place. By maintaining higher and more stable milk prices compact dairy farmers produce more milk than they would produce under lower and more uncertain milk prices.

Reports also show higher consumer prices have reduced beverage milk sales in compact regions. Milk production in excess of fluid needs in the compact region is channeled into the production of manufactured dairy products like cheese. The increase supply of manufactured dairy products lowers the price of these products and in turn the pay price to dairy farmers in manufacturing use markets. Since dairy compacts do not work for milk used to make manufactured dairy products because these products compete for a national market, compacts do not make economic sense nor would have much of positive impact for dairy farmers in manufacturing use markets. Yet these same producers suffer the consequences of any lower milk prices due to compacts. So dairy compacts will receive strong political support from many Northeast, South and Southeast states with strong opposition from the Upper Midwest and portions of the Northwest. Political trade offs could well occur to keep and/or expand dairy compacts in return for some dairy price support program of benefit to manufacturing milk use regions. The Northeast dairy compact was the result of political trade offs in the 1996 Farm Bill. For the authorization of the Northeast compact the Upper Midwest got the Secretary of Agriculture to consolidate the 31 existing federal milk marketing orders to not more than 14 or fewer than 10 and to study and make recommendations for improving pricing provisions of federal orders. Nevertheless, the orders were consolidated to 11, but as indicated the Upper Midwest remains dissatisfied with provisions of federal milk marketing orders and amendments to orders is still on going.

## ■ Summary:

As can be seen milk pricing is quite complicated in the U.S. Further, considerable regionalism exists between regions that are primarily fluid milk use markets and regions that are primarily manufacturing milk use markets. Current dairy policy does not treat all regions equitably now. While not all regions are impacted equally by low milk prices, all regions feel milk prices overall are too low and too volatile. But within each region there is also some support to get the government entirely out of price and income protection and let market forces work. But it appears that the entire freedom to farm under the 1996 Farm Bill needs review and that farmers may need a greater safety net for prices and income. With this in mind, some federal dairy price support program is very likely. The two greatest possibilities is a continuation of a CCC dairy product purchase program as has existed for 50 years or a target price deficiency type of program. Some type of supply management has some possibility but only at a voluntary level.