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Dairy Policy Issues

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SUMMARY

Several dairy issues have been or are being considered by the 109th Congress, some of which affect the three major federal dairy policy tools — the Milk Income Loss Contract (MILC) program, federal milk marketing orders, and the dairy price support program.

Under the MILC program, eligible dairy farmers receive a government payment when the farm price of milk used for fluid consumption falls below an established target price. The original legislative authority for the MILC program expired on September 30, 2005. However, a provision in the FY2006 budget reconciliation act (P.L. 109-171) extended the program for two additional years. As a cost-saving measure, P.L. 109-171 prohibits any MILC payments for the last month of its extended authority (September 2007), which, under current budget rules, means that the program will have no baseline budget spending allocated to it beyond its expiration date. A provision in the House-reported version of the FY2007 agriculture appropriations bill (H.R. 5384) would have allowed payments in September 2007 and preserved the program's budget baseline for the next farm bill debate in 2007. However, the provision was deleted on a point of order on the House floor, primarily because of its budget implications.

Federal milk marketing orders regulate the farm price of milk for roughly two-thirds of U.S. milk production by requiring processors to pay minimum prices for farm milk depending in its end use. On April 11, 2006, the President signed into law a measure (P.L. 109-215, S. 2120) that addresses farm milk pricing issues relevant to the western United States. Under previous regulations, producer-handlers (i.e., fluid milk handlers who produce and process their own milk) were exempt from federal order price regulation. P.L. 109-215 requires a large producer-handler in Arizona to become regulated. The provision was supported by other milk producer and processor groups who contend that unregulated processors undercut the competition. The producer-handler argues that the provision is a tax being placed on its operations that adversely affect its business, and ultimately result in higher prices to consumers. Meanwhile, USDA has issued final regulations effective April 1, 2006, that eliminates the exemption from federal order pricing for any producer-handler in the Southwest or Pacific Northwest who bottles more than 3 million pounds of milk per month. A Southwest producer-handler has challenged USDA's new regulation in the courts.

Separately, the Administration's FY2007 budget request contains three legislative proposals that would reduce net federal dairy expenditures by more than $1.2 billion over 10 years — (1) an assessment of 3 cents for every one hundred pounds of milk production, to be paid by all dairy farmers; (2) a 5% across-the-board reduction in government spending for all farm commodity support programs, which would apply to the MILC program; and (3) enhanced authorities for USDA to adjust federal purchase prices of surplus dairy commodities.

Dairy farmer groups are concerned that imports of milk protein concentrates (MPCs) are displacing domestic dairy ingredients and thus depressing farm milk prices. Bills have been introduced (H.R. 521 and S. 1417) to impose tariff rate quotas on certain MPCs. Dairy processor groups are opposed to this provision.

MOST RECENT DEVELOPMENTS

The House-reported version of the FY2007 agriculture appropriations bill (H.R. 5384) contained a provision that would have extended authority for government payments to dairy farmers under the Milk Income Loss Contract (MILC) program for one additional month, through September 30, 2007. On May 23, 2006, the provision was deleted from the bill on the House floor on a point of order that it constituted legislating in an appropriations bill. Proponents of deficit reduction were opposed to the one-month extension of MILC payments because it would have allowed new spending in the next farm bill that was not previously authorized. The MILC program provides direct payments to participating dairy farmers when the market price of farm milk falls below a legislatively determined target price.

On April 11, 2006, the President signed into law a measure (P.L. 109-215, S. 2120) requiring the regulation of a certain large dairy operation in the West that was previously exempt from paying federally mandated minimum farm milk prices. Meanwhile, USDA issued a final regulation effective April 1, 2006, that requires this dairy operation and all other large producer-handlers (fluid milk handlers who produce and process their own milk) in the West to become regulated under federal milk marketing orders. The new USDA regulation is being challenged in the courts.

The Administration's FY2007 budget request released on February 6, 2006, contains three legislative proposals that it says would reduce net spending on federal dairy programs by about $1.2 billion over 10 years, including a 3-cent assessment on every one hundred pounds of milk production, to be paid by all dairy farmers; a 5% across-the-board reduction in all commodity support payments to farmers, including MILC payments; and enhanced authorities for USDA to adjust federal purchase prices of surplus dairy commodities. Legislation would be required to implement these proposals, which dairy farmers strongly oppose.

BACKGROUND AND ANALYSIS

Milk Income Loss Contract (MILC) Payments

Background

In FY1999-FY2001, Congress provided just over $32.5 billion in emergency spending for USDA programs, primarily to help farmers recover from low farm commodity prices and natural disasters. The majority of these funds were for supplemental direct farm payments made to producers of certain commodities, primarily grains and cotton, but also including soybeans, peanuts, tobacco and milk. Of this amount, dairy farmers received supplemental "market loss" payments of $200 million in FY1999 under the Omnibus Consolidated and Emergency Supplemental Appropriations Act, 1999 (P.L. 105-277), $125 million under the FY2000 agriculture appropriations act (P.L. 106-78), and $675 million under the emergency provisions in the FY2001 agriculture appropriations act (P.L. 106-387).

Some dairy farmer groups sought a permanent direct payment program for dairy farmers to be included in the 2002 farm bill as a means of supplementing dairy farm income when

farm milk prices are low. Prior to the emergency payments made each year on an ad-hoc basis in FY1999 through FY2001, dairy farmers generally were not recipients of direct government payments. However, some groups contended that farm milk prices had been volatile in recent years and that dairy farmers needed more income stability.

Separately, the Northeast Dairy Compact, which provided price premiums to New England dairy farmers when market prices fell below a certain level, expired on September 30, 2001. These premiums were funded by assessments on fluid milk processors, whenever fluid farm milk prices in the region fell below $16.94 per hundredweight (cwt.). Supporters of the Northeast Compact had sought for an extension of the compact; the southeastern states were seeking new authority to create a separate compact. However, dairy processors and Upper Midwest producers strongly oppose regional compacts.

MILC Program Mechanics

Section 1502 of the Farm Security and Rural Investment Act of 2002 (P.L. 107-171, the 2002 farm bill) authorized a new counter-cyclical national dairy market loss payment program. (Upon implementation, USDA dubbed the program the Milk Income Loss Contract (MILC) program.) This program did not replace the dairy price support program or federal milk marketing orders, other current federal milk pricing policy tools. Instead, it serves as an alternative to regional dairy compacts and ad-hoc emergency payments to farmers, by authorizing additional federal payments when farm milk prices fall below an established target price. Authority for the MILC program expired on September 30, 2005, as required by the 2002 farm bill. However, the Deficit Reduction Act of 2005 (P.L. 109-171, S. 1932, enacted February 8, 2006) authorized a two-year extension of the program until September 30, 2007. (See "MILC Program Reauthorization" below for details.)

Under the MILC program, dairy farmers nationwide are eligible for a federal payment whenever the minimum monthly market price for farm milk used for fluid consumption in Boston falls below $16.94 per hundredweight (cwt.). In order to receive a payment, a dairy farmer must enter into a contract with the Secretary of Agriculture. Under the original farm bill authority, a producer received a payment equal to 45% of the difference between the $16.94 per cwt. target price and the market price, in any month that the Boston market price falls below $16.94. As a cost-saving measure, P.L. 109-171 reduced the payment rate from 45% to 34% effective for MILC payments in any month from October 2005 through August 2007. Under the law, a producer can receive a payment on all milk production during any month, but no payments are made on any annual production in excess of 2.4 million pounds per dairy operation.

The MILC program is akin to the Northeast Dairy Compact, which was in effect in the six New England states from 1997 until its expiration on September 30, 2001. However, under the expired dairy compact, dairy processors were required to pay the full difference between the $16.94 per cwt. fluid milk target price and any market price shortfall for fluid use milk in the compact region. The MILC program shifted the responsibility of the payment from the processor (and ultimately the consumer) to the federal government.

During the 2002 farm bill debate, the dairy payment program was generally supported by milk producer groups in the Northeast and the Upper Midwest. Producer groups in the Northeast region viewed it as an alternative to the Northeast dairy compact. Upper Midwest

producers preferred the new program to state compacts since the new program shares the price premiums nationally. Large dairy farmers expressed concern that the new program would cause excess milk production that would in turn decrease farm milk market prices. They contend that this negatively affects their income, since their annual production is well in excess of the 2.4 million lb. payment limit, and any production in excess of 2.4 million pounds receives the market price and no federal payments. (Annual production of 2.4 million pounds is roughly equal to the annual production of a herd of approximately 120 to 130 dairy cows.)

Table 1. Monthly Milk Income Loss Contract (MILC) Payment Rates

Month	Payment (per hundredweight)	Month	Payment (per hundredweight)
December 2001	$0.77	June 2003	$1.78
January 2002	$0.78	July 2003	$1.76
February 2002	$0.78	August 2003	$1.22
March 2002	$0.93	Sept.- Dec. 2003	$0.00
April 2002	$1.00	January 2004	$0.83
May 2002	$1.09	February 2004	$0.95
June 2002	$1.20	March 2004	$0.79
July 2002	$1.38	April 2004	$0.02
August 2002	$1.45	May 2004-May 2005	$0.00
September 2002	$1.45	June 2005	$0.03
October 2002	$1.59	July-November 2005	$0.00
November 2002	$1.39	December 2005	$0.04
December 2002	$1.43	Jan.-Feb. 2006	$0.105
January 2003	$1.41	March 2006	$0.41
February 2003	$1.56	April 2006	$0.84
March 2003	$1.75	May 2006	$0.925
April 2003	$1.82	June 2006	$1.00
May 2003	$1.79		

Source: USDA, Agricultural Marketing Service (AMS)

MILC Program Reauthorization Issues

The 2002 farm bill required the MILC program to expire on September 30, 2005, while all other major farm commodity support programs authorized by the farm bill are scheduled to expire at the end of the 2007 crop year. Proponents of the MILC program wanted program expiration to coincide with the expiration of all other commodity support programs. Hence, a provision in the FY2006 omnibus reconciliation act (P.L. 109-171, S. 1932) extends the MILC program through September 30, 2007. It also reduces the MILC payment rate so that a recipient receives 34% of the difference between the target price and the lower market

price, instead of the 45% payment rate in the recently expired program. This payment rate reduction is effective from October 2005 through August 2007.

The payment rate was reduced as a budget-saving measure in order to keep the two-year estimated cost of program extension just below $1 billion. (CBO estimated the two-year cost of the provision at $998 million, compared with $1.2 billion if the program had been extended without the payment rate reduction.) Also, in order to minimize the cost of program extension, P.L. 109-171 reduced the MILC payment rate to 0% in September 2007, the last month of program authority. This means that when the next farm bill is formulated in 2007, the MILC program will have no baseline budget spending allocated to it beyond August 2007. Subsequently, MILC program supporters attached an amendment to the House-reported version of the FY2007 agriculture appropriations bill (H.R. 5384) that would have required MILC payments to be made in September 2007 at the 34% payment rate, in order to preserve its baseline budget allocation beyond its current authorized life. This provision was deleted under a point of order on the House floor. Deficit reduction proponents opposed the extension, stating that it would add $1.8 billion over five years (FY2007-FY2012) to the cost of the next farm bill.

Although the MILC program originally expired on September 30, 2005, and was not extended until several months after that date, P.L. 109-171 allowed for USDA to make MILC payments retroactively for December 2005 through May 2006. For FY2006, USDA will accept applications in two phases. Eligible milk producers have until May 17, 2006 to sign up for payments to begin with one of the retroactive payment months (December 2005 through May 2006). After May 17, retroactive payments will no longer be available, and a producer can only choose to begin receiving payments in the current month or a future month. (For a USDA fact sheet on the FY2006 MILC program, see [http://www.fsa.usda.gov/pas/publications/facts/milc06.pdf].)

MILC Payment History

USDA began accepting applications for the original MILC Program" on August 15, 2002. (See **Table 1** for MILC payment history.) Monthly market prices were sufficiently low between December 2001 and August 2003 that MILC payments were made in every month during this period. Beginning in the late summer months of 2003, market farm milk prices greatly improved, rebounding from a 25-year low that prevailed throughout most of the early months of 2003. Hence, no MILC payments were required in September through December 2003. However, farm milk prices began to decline again in the latter part of 2003. Consequently, MILC payments resumed in January and February 2004. Market farm milk prices reversed their course in the late winter months and early spring of 2004, increasing to record high levels by the spring of 2004. Market prices remained sufficiently high from May 2004 through May 2005 so that no MILC payments were required over that time period. Market prices declined to the point that a small MILC payment ($0.03 per cwt.) was made for June 2005 milk production, the only payment that was made in all of FY2005. However, market prices declined in late 2005, triggering payments in each month from December 2005 through April 2006.

Federal Cost of MILC

For the first three years of the MILC program, its cumulative cost was just over $2 billion — $1.8 billion in FY2003, $221 million in FY2004, and $8.8 million in FY2005. The FY2003 total actually includes two fiscal years worth of payments, since retroactive payments for FY2002 were made over the course of FY2003. FY2004 and FY2005 outlays were significantly lower than originally estimated because market farm milk prices were much stronger than originally forecasted, reaching a record high in the summer of 2004. Farm milk prices remained strong throughout all of FY2005, and MILC payments were triggered in only one month during the year (June 2005). During the first three fiscal years of the program (FY2003-FY2005), five states accounted for just over one-half of the total payments made over the time period (see **Table 2**). The Congressional Budget Office (CBO) estimates that MILC program outlays will be $428 million in FY2006 and $502 million in FY2007. However, these estimates can change based on market conditions.

Table 2. Top 20 Recipient States of MILC Payments, FY2003-2005 Cumulative Total

($ in millions)

State	FY2003-2005 Total Payments	State	FY2003-2005 Total Payments
1. Wisconsin	$415.2	11. Missouri	$39.8
2. New York	$187.0	12. Idaho	$39.1
3. Pennsylvania	$181.3	13. Illinois	$38.1
4. Minnesota	$163.6	14. Washington	$36.0
5. California	$149.1	15. Kentucky	$34.6
6. Michigan	$84.9	16. Indiana	$33.9
7. Ohio	$76.5	17. Virginia	$33.1
8. Iowa	$67.4	18. Tennessee	$27.1
9. Vermont	$45.4	19. South Dakota	$22.5
10. Texas	$45.3	20. Maryland	$20.1
20-State Total	**$1,740.1**		
U.S. Total	**$2,025.4**		

Source: U.S. Department of Agriculture, Farm Service Agency

Dairy Price Support Program

Background and Spending

The Agricultural Act of 1949 first established the dairy price support program by permanently requiring USDA to support the farm price of milk. Since 1949, Congress has regularly amended the program, usually in the context of multi-year omnibus farm acts and budget reconciliation acts. (See **Table 3**, below, for a recent history of spending on the dairy

price support program and related activities.) Most recently, Section 1501 of the Farm Security and Rural Investment Act of 2002 (P.L. 107-171, the omnibus 2002 farm bill) authorized a 5½-year extension of the program through December 31, 2007, at the then-current support price of $9.90 per hundredweight (cwt.) of farm milk.

Table 3. Commodity Credit Corporation Dairy Price and Income Support Operations, 1980/81-2004/05

Marketing Year[a]	Net Removals Milk Equivalent (billion lbs.)[b]	Net Outlays (million $)	CCC Support Price ($ per cwt.)	CCC Purchases as Percentage of Production
1980-81	12.7	1,975	13.10	9.6
1981-82	13.8	2,239	13.49-13.10	10.2
1982-83	16.6	2,600	13.10	12.0
1983-84	10.4	1,597	13.10-12.60	7.6
1984-85	11.5	2,181	12.60-11.60	8.2
1985-86	12.3	2,420	11.60	8.5
1986-87	5.4	1,238	11.60-11.35	3.8
1987-88	9.7	1,346	11.10-10.60	6.7
1988-89	9.6	712	10.60-11.10	6.7
1989-90	8.4	505	10.60-10.10	5.7
1990-91	10.4	839	10.10	7.0
1991-92	10.1	232	10.10	6.7
1992-93	7.6	253	10.10	5.0
1993-94	4.2	158	10.10	2.8
1994-95	2.9	4	10.10	1.8
1995-96	0.1	-98	10.10-10.35	0.1
1996-97	0.7	67	10.20	0.4
1997-98	0.7	291	10.20-10.05	0.4
1998-99	0.3	480 [c]	10.05-9.90	0.2
1999-2000	0.8	684 [d]	9.90	0.5
2000-01	0.3	1,140 [e]	9.90	0.2
2001-02	0.2	622	9.90	0.1
2002-03	0.5	2,494 [f]	9.90	0.3
2003-04	NA	295 [g]	9.90	NA
2004-05	NA	- 95 [h]	9.90	NA

Source: U.S. Department of Agriculture, Farm Service Agency, selected publications.
a. The marketing year is October 1-September 30.
b. The milk equivalent is the pounds of fluid milk used to manufacture cheese and butter, on a milkfat basis.
c. Includes $200 million in emergency "market loss" payments authorized by P.L. 105-277.
d. Includes $125 million in net outlays for market loss payments authorized by P.L. 106-78.
e. Includes $675 million in market loss payments authorized by P.L. 106-387.
f. Includes $1.8 billion in Milk Income Loss Contract (MILC) payments.
g. Includes $221 million in MILC payments.
h. Includes $9 million in MILC payments . Net outlays in 2004-05 were negative because USDA's disposition of surplus dairy product inventory exceeded product purchases.

Historically, the supported farm price for milk is intended to protect farmers from price declines that might force them out of business and to protect consumers from seasonal imbalances of supply and demand. USDA's Commodity Credit Corporation (CCC) supports milk prices by its standing offer to purchase surplus nonfat dry milk, cheese, and butter from dairy processors. Government purchases of these storable dairy products indirectly support the market price of milk for all dairy farmers. Prices paid to the processors are set administratively by USDA at a level that should permit them to pay dairy farmers at least the federal support price for their milk.

In order to achieve the support price of $9.90 per cwt. of milk, USDA has a standing offer to processors to purchase surplus manufactured dairy products at the following prices: $1.05 per lb. for butter, $0.80 for nonfat dry milk, $1.1314 per lb. for block cheddar, and $1.1014 per lb. for barrel cheese. Whenever market prices fall to the support level, processors generally make the business decision of selling surplus product to the government rather than to the marketplace. Consequently, the government purchase prices usually serve as a floor for the market price, which in turn indirectly support the farm price of milk at $9.90 per cwt.

The dairy price support program is separate from the Milk Income Loss Contract (MILC) payments that also were authorized by the 2002 farm bill. (See the section above in this brief for more on the MILC payment program.) However, the MILC payments are considered a related activity to the price support program. Hence, MILC outlays are included in **Table 3**.)

The Administration's FY2007 Budget Proposal

In its FY2007 budget request released on February 6, 2006, the Administration made several proposals for reducing the cost of all federal farm commodity price and income support programs over a multi-year period. As part of dairy's contribution to deficit reduction, the Administration made three separate proposals that it says would reduce the net cost of federal dairy policy by nearly $1.2 billion over 10 years: (1) an assessment of 3 cents for every one hundred pounds of milk production to be paid by all dairy farmers; (2) a 5% across-the-board reduction in all farm commodity support payments, including the Milk Income Loss Contract (MILC) program; and (3) enhanced authority for USDA to adjust the government purchase prices for surplus dairy products under the dairy price support program in order to minimize government costs. Legislation would be required to authorize any of these policy changes. Last year, the Administration proposed two of these changes (the 5% rescission and the enhanced price support authorities). However, neither proposal was considered when the agriculture committees recommended spending reductions as part of the FY2006 budget reconciliation process. Major dairy farm groups oppose these proposals which they say comes at a time when dairy farmers are feeling the burden of higher production costs. Dairy processor groups, which support any efforts to restrain federal spending on dairy production support, generally concur with the Administration's dairy proposals.

The proposed 3 cents per hundredweight (cwt.) assessment on all milk production would generate average revenue of $58 million per year for the federal government to help defray the federal budget deficit, according to Administration estimates. A similar type of

assessment mechanism previously was required of dairy farmers from January 1991 through April 1996, as part of two separate budget reconciliation acts in the early 1990s. During this period, the assessment ranged from 5 cents to 11.25 cents per cwt., before it was repealed by the 1996 farm bill. Dairy farm groups are strongly opposed to any assessment calling it a "tax" on their operations which they estimate would reduce their income by an average of $5.86 per cow per year.

The Administration proposal to give USDA more flexibility within the dairy price support program would allow the Secretary of Agriculture to adjust the government purchase prices of surplus butter and nonfat dry milk (powder) so that government purchases and federal costs can be minimized. Under current law, USDA has the authority to adjust the butter and powder prices twice annually, which it has exercised infrequently. Whenever USDA reduces the purchase price of one product, it must increase the purchase price of the other in order to continue supporting the overall farm price of milk at the mandated level of $9.90 per cwt. The Administration proposes the elimination of the twice a year limit on price adjustments and instead would require USDA to adjust purchase prices when surplus dairy product purchases are excessive, in order to minimize federal costs. It also would prohibit USDA from purchasing any dairy products under the price support program in any month that the prior month's market price of the commodity is above the support price. The Administration estimates that its dairy price support proposals would save $618 million over 10 years. Proponents say that in the long run the Administration's proposal would reduce government costs and make domestic milk products more competitive in world markets. Most dairy farmer groups oppose reductions in government purchase prices, and contend that the income of all dairy farmers would be adversely affected.

Federal Milk Marketing Order Issues

Background on Federal Milk Marketing Orders

The farm price of approximately two-thirds of the nation's fluid milk is regulated under federal milk marketing orders. Federal orders, which are administered by the U.S. Department of Agriculture (USDA), were instituted in the 1930s to promote orderly marketing conditions by, among other things, applying a uniform system of classified pricing throughout the market. Some states, California for example, have their own state milk marketing regulations instead of federal rules. Producers delivering milk to federal marketing order areas are affected by two fundamental marketing order provisions: the classified pricing of milk according to its end use, and the pooling of receipts to pay all farmers a blend price.

Proponents of federal orders argue that orders are necessary because dairy farmers have a competitive disadvantage vis-à-vis dairy handlers (processors) when it comes to determining prices that farmers receive for their raw, perishable milk. Federal orders regulate handlers who sell milk or milk products within a defined marketing area by requiring them to pay not less than established minimum class prices for the Grade A milk they purchase from dairy producers, depending on how the milk is used. This classified pricing system requires handlers to pay a higher price for milk used for fluid consumption (Class I) than for milk used in manufactured dairy products such as yogurt, ice cream, and

sour cream (Class II products), cheese (Class III), and butter and dry milk products (Class IV products). These differences between classes reflect the different market values for the products.

Blend pricing allows all dairy farmers who ship to the market to pool their milk receipts and then be paid a single price for all milk based on order-wide usage (a weighted average of the four usage classes). Paying all farmers a single blend price is seen as an equitable way of sharing revenues for identical raw milk directed to both the higher-valued fluid market and the lower-valued manufacturing market.

Manufactured class (Class II, III and IV) prices are the same in all orders nationwide and are calculated monthly by USDA based on current market conditions for manufactured dairy products. The Class I price for milk used for fluid consumption varies from area to area. Class I prices are determined by adding to a monthly base price, a "Class I differential" that generally rises with the geographical distance from milk surplus regions in the Upper Midwest, the Southwest, and the West. Class I differential pricing is a mechanism designed to ensure adequate supplies of milk for fluid use at consumption centers. The supply of milk may come from local supplies or distant supplies, whichever is more efficient. However, local dairy farmers are protected by the minimum price rule against lower-priced milk that might otherwise be hauled into their region.

Milk Regulatory Equity Act of 2005 (P.L. 109-215, S. 2120)

On April 11, 2006, the President signed into law the Milk Regulatory Equity Act (P.L. 109-215, S. 2120), which addresses several federal milk marketing order issues relevant to the western United States. Among the milk marketing order issues addressed in H.R. 4015/S. 2120 are (1) the regulation of fluid milk processors who operate a plant in a federal order area, are not regulated by that order, and ship packaged milk into a state marketing order (not a federal order); (2) the regulation of fluid processors who produce, package and distribute their milk, also known as producer-handlers or producer-distributors; and (3) the exclusion of Nevada from federal milk marketing orders.

Regulation of Certain Interstate Milk Shipments. P.L. 109-215 affects any processor (handler) of Class I (fluid-use) milk who operates a plant that is located in a federal milk marketing order area, is not regulated by the federal order because it has no sales in the federal marketing area, and has packaged fluid milk deliveries to a state that is regulated by a state marketing order. Such a plant is not currently paying a regulated price for the raw milk that is used for these dispositions or sales. The bill would require any such processor to pay into the federal order pool the minimum federal milk marketing order price for the raw milk that went into the shipments sold into the state order.

This provision is targeted at a large fluid processor who is located in Yuma, Arizona (which is part of the Arizona-Las Vegas milk marketing order area), but ships all of its packaged milk into California. Under current law and regulations, this plant's interstate shipments to California are not regulated by either the Arizona-Las Vegas order or the California state order. This provision is supported by other processors and milk producers who contend that this processor's current exclusion from paying the minimum regulated price is a "loophole" in the current federal order system, which they say provides that processor with an unfair price advantage. Opponents of this provision contend that it would

adversely affect their operations and raise the price of milk to consumers. They also contend that Congress and USDA should hold hearings on the issue before any legislative changes are considered.

Producer-Handler Exemption. As defined by USDA, producer-handlers are dairy farmers who process milk from their own cows in their own plants and market their packaged fluid milk and other dairy products themselves. Producer-handlers sometimes are referred to as producer-distributors, or P-Ds. Producer-handlers may sell products directly to consumers through their own stores, directly to consumers on home-delivery routes, or to wholesale customers such as food stores, vendors, or institutions. Current regulations exempt producer-handlers from the minimum price requirements of federal milk marketing orders, but minimal reporting is required.

P.L. 109-215 requires the full regulation of any producer-handler with distribution of fluid milk in the Arizona-Las Vegas order area in excess of 3 million pounds in the previous month. The act primarily affects the same producer-handler in Arizona that is affected by the interstate milk shipment provision discussed above. Meanwhile, USDA has published a final regulation effective April 1, 2006, that establishes a 3 million lb. per month route disposition limit for a producer-handler exemption, both in the Pacific Northwest and the Arizona-Las Vegas order areas. The final USDA regulation affects at least three large producer handlers in the Pacific Northwest, as well as the Arizona producer-handler. (For USDA's final rule, see [http://a257.g.akamaitech.net/7/257/2422/01jan20061800/edocket.access.gpo.gov/2006/06-1587.htm].) The Arizona producer-handler (Hein Hettinga) is challenging the new USDA regulation in court.

The producer-handler provision is a separate issue from the provision above relating to the interstate shipment of milk, but with similar implications. Producers of regulated milk want this unregulated milk to become regulated so it will increase the blend price received by all regulated dairy farmers. Regulated processors contend that it is unfair that they have to pay the regulated price while certain handlers are exempt. The producer-handlers who would become regulated argue that this is a tax being placed on independent family farms that would ultimately result in higher prices to consumers.

Nevada Exclusion from Federal Milk Marketing Orders. Section 760 of the FY2000 agriculture appropriations act (P.L. 106-78) was intended to remove Clark County, Nevada from the Las Vegas-Arizona federal milk marketing order area so that the only handler in this county would be subject to the lower Nevada state order price for fluid milk. However, the enacted provision was phrased in a way that did not completely remove Clark County from the federal order system. The enacted language exempted any plant operating in Clark County from being subject to any federal milk marketing order. However, it did not remove Clark County from the Arizona-Las Vegas milk marketing order area. This means that milk that is currently shipped from California to Clark County is partially regulated and compensatory payments to the Arizona-Las Vegas order are required. Hence, a provision in P.L. 109-215 completely removes the state of Nevada from the marketing area definition of any order, which supporters say would end the required compensatory payments paid by California milk shippers and allow all of Nevada to be joined together in the state order.

Milk Protein Concentrate Trade Issues

Milk protein concentrate is a product in which certain milk proteins necessary for the production of cheese and other food products are selectively included and all or most of the water is removed from the milk, thus making it efficient to ship long distances. Dairy farmer groups are concerned that imports of MPC and casein (the main protein found in milk) are displacing domestic milk used for cheesemaking and depressing farm milk prices. Certain concentrations are not covered by tariffs or quotas under the existing World Trade Organization agreement. The importation of these products was not an issue when the agreement was formulated in the 1990s.

On March 5, 2001, the General Accounting Office released a study on the production, imports, and regulation of milk protein concentrates. The study found that MPC imports grew rapidly from 1990 to 1999 — from 805 to 44,878 metric tons, including a near doubling in 1999 over 1998 alone. According to the study, six countries (New Zealand, Ireland, Germany, Australia, the Netherlands and Canada) accounted for 95% of the 1999 imports. For the full text of the GAO study, see [http://www.gao.gov/new.items/d01326.pdf]. According to International Trade Commission data, MPC imports peaked in 2000 at 52,677 metric tons, before falling back to 28,469 metric tons in 2001, and rising again to 33,626 metric tons in 2002 and 29,111 metric tons in the first 10 months of 2003 (7.8% higher than the first 10 months of 2002). Imports of casein have also risen over the years, peaking at 74,230 metric tons in 2000, before declining in 2001 and 2002, but rising again in 2003 on a pace with the peak in 2000.

Currently, MPC is not allowed as an ingredient in any U.S. cheese which has a standard of identity defined by the Food and Drug Administration, which includes most cheese. Cheese processors petitioned FDA for a change in standards to allow MPC in cheese production. On October 19, 2005, FDA issued a proposed rule that would allow liquid ultra-filtered milk to be used in standardized cheeses. Processors say that the use of ultra-filtered milk enhances product consistency and allows for more efficient transportation of milk. This rule does not address the use of dry ultra-filtered milk (i.e, milk protein concentrate) in standardized cheese production.

Measures have been introduced in the 109th Congress (H.R. 521 and S. 1417) that would impose tariff rate quotas (TRQs) on certain MPCs. Under the proposed TRQ, any imports of MPC above the quota level would be subject to a high tariff that would economically prohibit MPC imports above that level.

Supporters of TRQs on MPC, including most milk producer groups, contend that foreign MPC and casein are being dumped in the United States. Opponents of the legislation include dairy processor groups, the largest of which is the International Dairy Foods Association (IDFA), who contend that MPC imports are not displacing U.S. production of nonfat dry milk. IDFA and other MPC-user groups contend that MPCs have certain properties that are important in the manufacturing of certain food products (e.g. high-protein sport drinks and food bars) and that nonfat dry milk is not a substitute for the use of MPCs. These groups also maintain that the domestic support price for nonfat dry milk should be reduced instead, as a way to stimulate the market for domestic powder. (For more information on the dairy price support program, see the section on the program in this brief.)

The National Milk Producers Federation (NMPF), the largest trade association representing milk producer cooperatives, has urged the federal government to examine several trade policy options for addressing the milk protein concentrate import issue. These include provisions in the Trade Act of 1974 that allow the President (following an International Trade Commission investigation) to provide relief to a U.S. industry adversely affected by imports; a 1974 Trade Act provision that allows the U.S. Trade Representative to retaliate against certain foreign trade policies; and the use of antidumping laws and countervailing measures.

On April 17, 2002, the NMPF filed a formal challenge concerning the U.S. Customs Service classification of various dairy product imports, including MPC. Under Section 516 of the Tariff Act of 1930, interested parties are permitted to challenge the tariff classification of imported items. The NMPF claims that imported MPC is not a true concentrated milk protein, but is instead a blend of other dairy products (such as nonfat dry milk, whey powder and casein). These blends, they say, "take unfair advantage of U.S. trade policies that allow the unrestricted entry of MPC, but not the individual components found in the blended products." On April 1, 2003, the Customs Service ruled that milk protein concentrates are classified correctly. It stated that the current definition of milk protein concentrate only requires that MPC's consist of at least 40% milk proteins, but does not specify whether the product is manufactured through the filtration of skim milk or the blending with nonfat dry milk or other components. The NMPF has announced an appeal of the Customs ruling, a process which could take more than one year.

As requested by the Senate Finance Committee, the International Trade Commission completed a year-long investigation of U.S. market conditions for milk proteins, and filed a written report on May 18, 2004. (See [http://hotdocs.usitc.gov/docs/pubs/332/pub3692.pdf] for the full report.) The ITC was asked to provide an overview of the global market of milk proteins, information on how government support and intervention affects the protein market, and assess how imported milk proteins affect U.S. farm milk prices. The ITC determined that imports of milk proteins may have displaced 318 million lbs. of U.S.-produced milk protein products over the 1998-2002 period, or an average of 63 million lbs. per year. The ITC states that during this period, domestic milk proteins were in surplus by a greater amount than what was likely displaced by protein imports. Therefore, they concluded that most of the impact of milk protein product imports was absorbed by the taxpayer through additional purchases of surplus nonfat dry milk, and that farm-level prices were not significantly affected. The ITC study also determined that the dairy price support program creates a disincentive to manufacture MPCs in the United States. They found that under most conditions, U.S. dairy processors could receive a higher return on the production of nonfat dry milk compared with the production of MPCs.

Legislation was introduced in the 108th Congress (H.R. 4223) that would have authorized a federal program to subsidize the domestic production of MPCs, with payment levels set at the discretion of the Secretary of Agriculture. No action was taken on the measure, and a similar bill has not been reintroduced in the 109th Congress. Supporters contend that the cost of these payments would be offset by reduced purchases of surplus nonfat dry milk. They say that manufacturers will divert production from surplus nonfat dry milk to MPCs, thus improving farm milk prices. Opponents are concerned that the proposed subsidy program might be subject to a challenge in the World Trade Organization. They also

contend that even with a subsidy program, it will be difficult for domestic producers to profit in the market because foreign competitors have a greater price advantage.