US Department of Agriculture **Subcommittee A**

Dairy Industry Advisory Committee **Final Report**

December 2010

Existing Laws and Programs to Impact Dairy Farm Profitability and Milk Price Volatility

Dairy Industry Advisory Committee

U.S. Department of Agriculture

Forward

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

Its Charter directs the Committee to review: 1) farm milk price volatility and 2) dairy farmer profitability. The Committee will advise the Secretary on how USDA can meet dairy farmers' needs.

This Committee is in the public's interest in view of the dairy industry's importance to the nation's economy. The exchange of views and information between industry representatives and USDA should improve understanding of the impact of USDA programs on the dairy industry and contribute to those programs' effective and efficient administration. The members of the Committee are as follows[1]:

[1] All members except Dr. Novakovic are considered under FACA to be serving as Representative Members and are appointed to obtain the perspectives of public sector stakeholders. Dr. Novakovic serves as a Special Government Employee under appointment by Secretary Vilsack.

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

Executive Summary

In 2009 dairy farmers suffered the joint effects of a cyclical downturn in milk prices, elevated input costs and a severe recession. The federal government has limited ability to respond to such events under existing legislation. Some laws provide no leeway to the Secretary of Agriculture, others allow some or even considerable discretion. When a Secretary's proposed action has or is likely to have an impact on government expenditures, even "discretionary" programs cannot be used without approval of the Office of Management and Budget.

This report identifies authority the Department of Agriculture could use to the benefit of the dairy sector without new legislation. Several programs are explicitly designed for the dairy industry. Others are more generic but could also be used to benefit dairy.

In the previous two years, the Secretary of Agriculture invoked and leveraged a number of programs to assist dairy farmers through the market crisis. These actions included direct payments to farmers through the Dairy Economic Loss Assistance Payment (DELAP) Program; purchases of $125MM in cheese for the Food and Nutrition Service; purchases of $203MM in cheese and dairy products through the 2010 Agricultural Appropriations Act and other programs; nearly $1B in direct payments to dairy farmers through the MILC program; purchases of $227.5MM in nonfat dry milk through the Dairy Product Price Support Program; $108.6MM in direct loans to dairy farmers through the Farm Loan Program and significant loan guarantees, concessions and options for restructuring, rescheduling or deferring payments on existing FLP loans; and maximum allocations of Dairy Export Incentive Program volumes.

The Dairy Industry Advisory Committee recognizes that the Secretary must apply all of these approaches judiciously as government interventions have the potential to displace commercial production, disrupt existing dairy product markets and delay price recovery. However, economic conditions such as those felt by dairy farmers in 2009 that result from unanticipated economic shocks justify intervention. Therefore, the Committee has reviewed existing authorities and provides recommendations for how the Secretary could use those authorities most effectively to improve dairy farm profitability and reduce farm margin volatility.

If the Secretary can identify sources of money, he can use the Dairy Product Price Support Program and one or more food assistance programs to stimulate demand and lift prices. The Dairy Industry Advisory Committee suggests guidelines for use of these programs.

The Dairy Industry Advisory Committee also recommends that the Secretary of Agriculture review program administration to examine its impact on creating price volatility or delaying the government's response. In particular, the Dairy Product Price Support Program seems to operate with considerable delay and provides price support below the intended levels. Testimony before the Committee indicated that administration of the Federal Milk Market Order system is inflexible and outdated. Moreover, the Market Order rules may be effectively transferring volatility in narrow subsectors of the dairy market into wider milk prices. Some changes in administration of these programs are within the authority of the Secretary of Agriculture.

Allocating part of the U.S. government's budget to dairy farm programs necessarily involves tradeoffs with other programs. The Committee suggests that political pressures in the allocation process can be reduced by using objective measures of sector hardship. We recommend that the Secretary implement trigger levels based on the difference between average milk prices and some index of feed costs. The Secretary can demonstrate objectively that dairy farmers face extreme hardship when the difference between revenue and cost falls below the trigger levels. That would justify shifting resources from other uses that may not be as critical. Within this framework, the first trigger indicates that a food assistance program should be used. At the second trigger, the DPPSP purchase prices should be raised. The committee recommends caution in application of these responses.

The recommendations presented in this document are framed from the perspective of the DIAC charge only as it relates to the Secretary's current authorities. A future report will include recommendations for removing, adding or changing federal programs to provide a more comprehensive and long-lasting improvement in dairy farm profitability and margin volatility.

Table of Contents

Introduction

With the ink barely dry on the 2008 Farm Bill, the U.S. economy descended into the worst recession since the Great Depression of the 1930s. The dairy industry suffered a combination of recession-driven demand effects and more sector-specific supply effects. Dairy exports, which had been a primary cause of dairy farm prosperity in 2007 and 2008, collapsed as global demand declined. Domestic demand, especially in foodservice, also shrank as consumers trimmed household budgets. On the supply side, the costs of feed, the single largest input into milk production, hit record highs. This in turn created the worst price:cost squeeze since the early 1970s. While the industry was poised for a cyclical downturn in any event, the global economic downturn, in combination with record grain prices, pushed most dairy farm businesses into the red and eliminated years of growth in dairy farm balance sheets.

Although net income for dairy farmers is much improved in 2010, weakened balance sheets leave farmers vulnerable in the current uncertain economic environment. Recent increases in corn futures markets indicate that dairy farm expenses may once again stress farm margins in 2011.

This report catalogs current federal laws and programs intended to assist dairy farmers and discusses their potential application and limitations in various market environments.

Milk Price Volatility

Before the Agricultural Act of 1949 established the Dairy Price Support Program (DPSP), farm milk prices exhibited a high degree of instability, but these fluctuations were primarily seasonal and generally predictable. From 1950 to 1989, milk price variability was considerably dampened compared to the first half of the twentieth century. During the 1970s, the primary price mover was inflation, which affected the entire U.S. economy. From 1981 to 1990, dairy markets were characterized by a variety of significant government programs, including large product purchases and herd buyouts, offsetting surpluses generated by aggressive support prices in the late 1970's. Beginning in 1980, the support price was gradually reduced from over $13.00 to an equivalent of under $10.00. At the current level of support, government purchases have been infrequent.

Since 1990, the farm milk price has become highly variable and unpredictable. We will describe this combination of instability and uncertainty as price volatility. The causes of this increased volatility are debatable. The reduction of the federal support price for milk seems to have revealed an underlying volatility or susceptibility to volatility. Dairy analysts have described dairy markets as having low price elasticities of supply and demand for farm level milk, and inelastic price elasticity of demand for many dairy products throughout the market chain. While analysts debate the degree of elasticity, most agree that short term elasticities are small. As such, small relative changes in quantities are associated with relatively large changes in price.

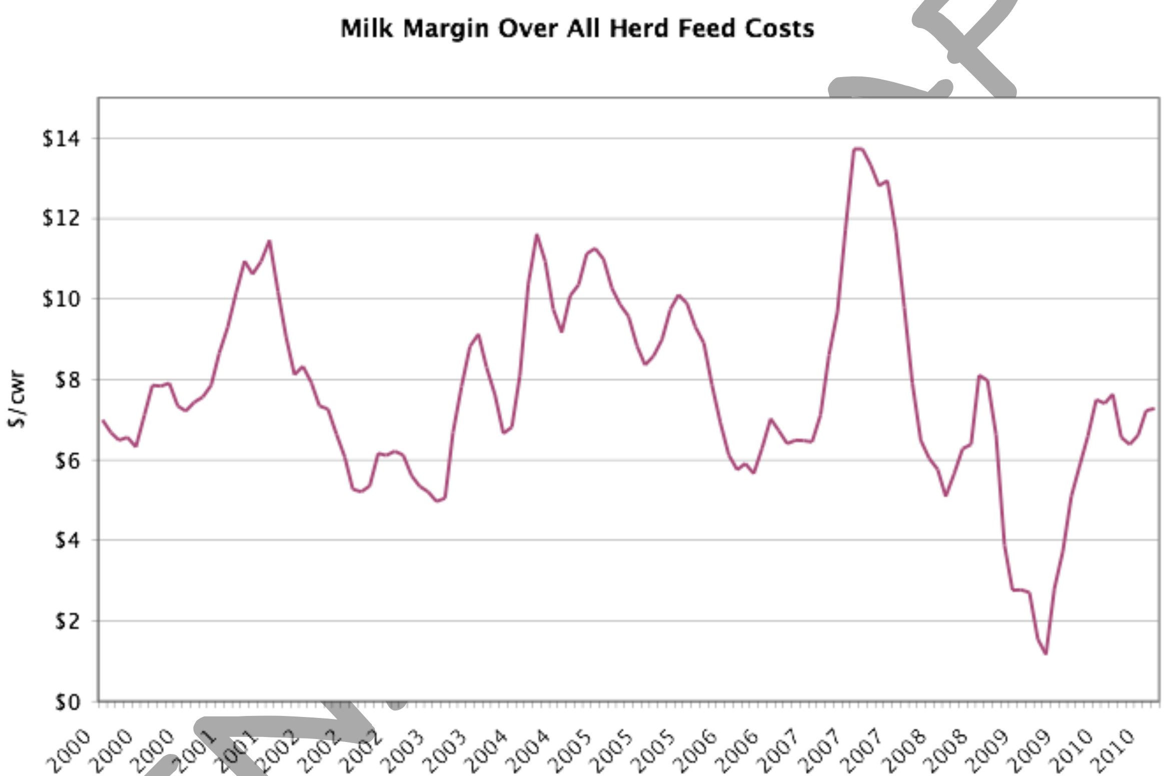
This onset of price instability corresponds to two significant changes in administration of federal programs. The Dairy Price Support Program (DPSP) was replaced by the Dairy Product Price Support Program (DPPSP). Also, the base price for Federal Milk Marketing Order formulas was changed from competitive prices paid to a certain dairy farm demographic to prices of specific dairy commodities. In both these cases, programs were tied to narrowly defined product categories that experienced more price volatility than the market as a whole. We recommend further analysis of how these program changes contributed to the volatility of milk prices at the farm level.

Another significant policy event that seems have changed dairy markets was the conclusion of the Uruguay Round negotiations under the General Agreement on Tariffs and Trade, now referred to as the World Trade Organization (WTO). In the U.S., the Uruguay Round Agreements Act was passed in 1994. Under the Agreement on Agriculture (AoA), the United States agreed to increase the access to its dairy markets by foreign competitors (from about 2.5 percent to five percent). The United States also replaced its strict import quota system with a tariff-based system that generally provided a high degree of protection from most dairy commodities and greater access to value added products (such as European-style cheeses). In exchange for increasing access for imports, the United States dairy industry got greater access to foreign markets. The increased significance of trade subjected U.S. dairy markets to effects of changes in world supply and demand conditions, including weather, political shocks and foreign food safety issues. These may have contributed to increased price instability.

Costs of Production

In addition to swings in milk price, dairy farmers have experienced significant changes in costs of production. The single largest milk production component (40-50%) is the cost of feed. Thus, dairy farmers are especially sensitive to the prices of purchased feeds or to the prices of inputs used in homegrown feed production. Key feedstuffs are corn, soybeans, cottonseed and alfalfa hay. Other important production inputs are energy and labor and—for those who grow their own feed—fuel, fertilizer and seed.

From Fall 2006 through Summer 2008, the price that corn growers received increased from about $2.00 to about $5.50 per bushel. The increase in soybean prices was equally dramatic. Among other causes of feed price increases, expanded bio-fuel production created a large and new demand for corn and, because of acreage competition, contributed to the price increase for soybeans and other crops. Weather and international grain demand also contributed to high feed costs. Milk prices had hit a cyclical low in 2006. The high feed costs that decreased milk supply and the price of milk rose from a low of $11.70 per cwt in July 2006 to a high of $21.90 in November 2007—the all time record high for the nominal price of milk. In the early months of 2007, the rise in the price of milk did not keep pace with increases in feed costs. At the peak of the market, farm prices were more than enough to compensate for



high feed costs, net returns were generous and farmers increased milk production. By the end of 2008 and through 2009, the farm profitability equation had again turned against dairy farmers. Although corn prices and other input prices had softened from their highs due to record crop production, milk prices had fallen even more. The problem in 2009 was not just the price of milk, which was no lower than at the bottoms of the previous two cycles, but the unprecedented low to negative margins. In many months, the milk check barely covered the cost of feed. This is illustrated in the adjoining chart.

Clearly, the low point in Milk Margin over Feed Costs ($/cwt) during 2009 is far lower compared to the previous troughs in 2006 and 2002 although milk prices were approximately the same in the three years. The distinction between prices and margins is important. Prices impact margins and financial outcomes, but output price alone does not determine farmers' well-being. Most dairy and other agricultural support programs are based on or triggered by an output price, such as milk price. The usefulness of that simple approach, which seemed to work satisfactorily in the past, has been seriously challenged by the events of the last two years and is a concern looking forward to 2011 and beyond.

Current Legislative and Regulatory Authorities

Dairy programs are legal authorizations or mandates specified by Congress and implemented as regulations by the US Department of Agriculture or another executive agency of the federal government. Some of these programs exist under permanent law. Others are temporary. They may exist for many years, but periodically Congress needs to reaffirm them.

Congress has latitude in how strongly it directs an action of the Executive Branch. In many cases, a law authorizes USDA or another agency to do something, but it does not require or even enable that action. For example, under the old parity-based Dairy Price Support Program, the Secretary of Agriculture could announce a support price for milk that was no less than 75% of the parity price but no more than 90%. Thus, the Secretary was authorized to choose within a range. Sometimes, the Secretary is allowed to decide whether or not to do anything at all. For example, he or she is not required to implement a Federal Milk Marketing Order either by the instruction of Congress or at the request of farmers. The Secretary has the authority to deny a request for a new Order. Lastly, Congress may give the Secretary authority, but not funding to implement.

Below, we describe current programs that have direct effects on milk prices, dairy product sales, farm incomes, or other direct aspects of dairy profitability and volatility. Many programs outside of USDA authority affect dairy markets, including tax policy, public borrowing, transportation, fuel taxes, and environmental regulations. Our primary focus will be on dairy-specific programs that could reasonably impact dairy markets.

The Dairy Product Price Support Program

The Dairy Price Support Program (DPSP) was authorized under the Agricultural Act of 1949 and has been reauthorized by subsequent Farm Bills. The Act gave the Secretary of Agriculture discretion to establish a support price that would cover 75-90 percent of "parity" (a measure of farmers' purchasing power). In 1981, Congress suspended the requirement that the Secretary establish support prices within that range and, in 2008, the parity language was dropped altogether.

The 2008 Food Conservation and Energy Act (FCEA or "Farm Bill") also altered the purchase price targets, replacing a support price for milk with support prices for commodity cheddar cheese, butter and nonfat dry milk. This altered program was titled the Dairy Product Price Support Program (DPPSP). Purchase prices, specified in law by FCEA or announced by USDA prior to 2008, are listed in the following table:

Price	Before FCEA 08	After FCEA 08
Support Price for Milk Used in Manufacturing, average fat test	$9.90	not specified

Price	Before FCEA 08	After FCEA 08
Purchase Price for Cheddar Cheese, blocks	$1.1314	$1.13
Purchase Price for Cheddar Cheese, barrels	$1.1014	$1.10
Purchase Price for Butter	$1.05	$1.05
Purchase Price for Nonfat Dry Milk	$0.80	$0.80

USDA is obliged to buy any and all quantities of eligible product offered at the announced purchase prices. Typically, any such product so acquired will either be sold back into commercial markets at the sellback price or will be made available for use in a food assistance program (possibly under Sec. 416(b) or one of the domestic programs, such as TEFAP or School Lunch).

To the extent that manufacturers take advantage of this guaranteed price, market prices should not fall below the government offer price, or at least not by very much. In practice, sellers show some reluctance to sell cheese and butter to the government. USDA issues standards for product purchases that do not match the standards required by other market buyers and payment terms are outside of industry norms. In January 2009 wholesale cheddar cheese prices were six to seven cents per pound less than the USDA purchase price for three weeks without generating sales to the CCC. USDA should examine this market resistance and make program changes that minimize reluctance to participate.

The support prices assure manufacturers of these commodities that they will have a market for the products. Also, prices of these products are the foundation for federal order milk prices, so the effect of purchases is widespread. Some analysts suggest that the support price program has resulted in too many resources being directed toward production of the targeted commodities compared to other products that might have broader market opportunities. If the distortion leads to inefficient allocation of resources in dairy markets, returns to farmers will eventually be reduced.

Although Congress specified a fixed support price for milk from 1981 to 2008, when it passed the Food, Conservation, and Energy Act of 2008 it changed specifications of commodity support prices from “shall be” to “shall be no less than.” In so doing, the Act created authority for the Secretary to announce higher purchase prices than those specified in the bill.

Secretary Vilsack used that discretionary authority to increase the purchase prices for cheddar cheese and nonfat dry milk in August, September and October 2009. Compared to the purchase prices listed in the table above, the Secretary increased the purchase price of cheddar cheese by 18 cents per pound (16%) and nonfat dry milk by 10 cents per pound (15%). This action resulted in few dairy support program purchases by the CCC, as product prices increased over the same period.

In November 2009, support prices for cheddar cheese and nonfat dry milk under the DPPSP reverted to the levels specified in the FCEA. The Secretary's authority to make changes in the DPPSP support prices are limited by available funding. The Congressional Budget Office, using budgetary guidelines created by Congress itself, determines if Congress can afford to pass a bill that has budgetary implications. Once a bill becomes law, if it involves some discretionary action or decisions by the Secretary, then the President's Office of Management and Budget has the authority to decide if the Executive Branch can afford it.

Later in the report, the Committee the committee presents recommendations for the Secretary concerning use of discretionary authority over the DPPSP.

Milk Income Loss Contract

The Milk Income Loss Contract is a form of countercyclical income support that draws some elements from the structure of the Northeast Dairy Compact and the countercyclical price subsidies established for program crops (food and feed grains, etc) in the Farm Security Act of 2002.

The Northeast Dairy Compact was a Congressionally sanctioned agreement between the six New England states to coordinate a minimum price for Class I milk marketed in their jurisdiction. When Congressional approval for this multi-state Compact expired, the calculation methodology was adapted to a countercyclical income subsidy that would apply to all dairy farmers in the contiguous United States. The Boston city zone price of $16.94 was established as the price trigger. A payment rate was determined as 45 percent of the difference between the announced monthly price and the trigger, approximately the same percentage as the Class I utilization in New England. In addition, a payment limit was established based on the pounds of milk marketed by a single dairy operation. The quantitative limit represents a type of payment limitation that has two objectives. It limits government exposure to budget costs. Furthermore, it means smaller farmers will receive a greater benefit relative to their gross income, a policy objective that has had broad support in Congress. In this framework, the actual expenditures depend on the magnitude of the payment rate as well as the marketings payment limit. Inasmuch as many farms market more milk in a year than the annual marketing limit, farmers are allowed to choose the month when they become eligible to receive payments. Payments begin in that month or the first month thereafter in which a payment rate is announced and continue until the marketing limit is reached. Payments counting toward the limit reset in October of each year.

In the FCEA, Congress modified the trigger price to include an automatic adjustment for changes in the prices farmers pay for certain feeds used in a dairy ration. The national dairy ration cost is routinely calculated by USDA's National Agricultural Statistics Service. When the monthly ration cost exceeds $7.35 per cwt., the trigger price is increased by 45% of the difference between the ration-cost trigger and the estimated actual cost. For example, if the dairy ration cost is estimated to be 10% above $7.35, the milk payment trigger rises 4.5% (or $16.94 times 1.045 = $17.70). The FCEA reduces the MILC payment rate from 45 to 34 percent of the difference between the announced monthly price and the trigger price and increases the automatic feed adjustment trigger cost from $7.35 to $9.50 beginning on September 1, 2012.

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

Federal Milk Marketing Orders

Federal Milk Marketing Orders (FMMOs) are the oldest U.S. dairy industry specific programs. Milk marketing cooperatives used classified pricing and pooling long before passage of enabling federal and state legislation. Orders were adopted under both federal and state laws beginning in the 1930s. Over time, most state laws gave way to the federal law due to states' inability to price milk in interstate trade. However, several states continue to have some form of milk price regulation, including California, New York, Pennsylvania, Virginia, Maine, Montana, Nevada, and North Dakota.

Fluid milk processors are automatically subject to the requirements of a FMMO. Manufacturers of other dairy products are not automatically regulated. Instead, in order to share in Class I (beverage) milk price premiums, manufacturers of other products are required to demonstrate their capacity to supply milk to the fluid milk market. The specific performance or pool qualification requirements vary across orders. In addition to defining eligibility to participate in the order, these performance requirements can exclude competitors from the market order. The USDA must be vigilant to assure that criteria for participation are justified and not exploited by some groups of farmers to avoid sharing market order premiums with others.

Marketing orders are complex regulatory instruments. Many comprehensive descriptions are available to interested readers. Rather than focusing on the mechanics of the orders, the Committee wishes to highlight several aspects of market order operation that are related to its charge.

The AMAA of 1937 authorizes but does not mandate Federal Orders. Orders are initiated and amended through producer requests followed by formal hearings, briefings, recommended decisions, public comments and, ultimately, final decisions by USDA. The AMAA requires the Secretary to craft orders that are "in the public interest," meaning the Secretary has to balance the objectives and concerns of farmers with those of the rest of the supply chain as well as consumers. Changes in an order are approved by an affirmative vote of two-thirds of the dairy farmers whose prices would be subject to the order. Farmers may only vote for or against the entire order, they cannot vote on specific provisions of the order. If a vote fails, the order ceases to exist. Today, marketing orders cover about two-thirds of the US milk supply.

Federal Orders play a valuable role in oversight of compliance issues such as milk component testing, contract enforcement, auditing, and in data gathering and publication of statistics vital to market transparency.

The current structure of the Federal Order system uses end-product pricing to determine minimum classified prices. Under end-product pricing formulas, CME spot prices for cheese and butter have a large influence on milk prices, even though they are not used directly in the formulas. Processors typically use CME prices a reference to reduce their margin risk. Thus, the actual pay prices collected from plants by the National Agricultural Statistics Service (NASS) tends to be highly correlated with the CEM price. The spot commodity markets trade very little product relative to the total volumes manufactured and exhibit large and sometimes unpredictable swings in price. This aggravated price movement is translated to farmers as increased milk price volatility. There is a widespread concern that the CME markets are subject to manipulation by a small group of traders, although CME and the Commodity Futures Trading Commission, which has federal oversight, have repeatedly stated that trading activity is monitored and they do not find evidence of frequent or routine illegal manipulation.

Some other fundamental aspects of classified pricing and pooling may hamper dairy farmers' ability to innovate and create unintended incentives for both farmers and processors. Milk prices paid by processors of commodities referenced in classified prices tie relatively closely to their finished product prices. Manufacturers of other dairy products face additional risk as their prices and costs deviate from those of the referenced commodities. The reduced margin uncertainty for manufacturers of the basic commodities makes those commodities relatively low-risk investments. This distortion discourages dairy product innovation, reduces market efficiency, and therefore lowers money available for farmers.

Similarly, improvements in dairy processing technology and changes in consumer preferences may render some of the original justifications for classified pricing and/or pooling obsolete. In the mid-20th Century, the percentage of Federal Order milk marketing used to make fluid milk products was in the range of 60-65%. In the 21st Century, Class I utilization has been in the neighborhood of 40%. Developments in milk transportation and storage ability, long-term declines in per capita beverage milk consumption, establishment of extremely large farmer-owned cooperatives, development of protein filtration technology, the emerging product preferences of both domestic and global dairy consumers and a host of other factors necessitate a strategic look at the future role of Federal Orders, especially in its role in price setting and pooling.

While the Federal Orders have many functions in the dairy industry, the underlying structure, as well as the rulemaking required, means that the Federal Order system is not a viable vehicle for the Secretary of Agriculture to use to assist dairy farmers during periods of stress. However, the Committee recommends further work by USDA, this Committee or some other commission focused on analyzing the operations of the FMMO, including but not limited to end-product pricing's impact on milk price volatility and impact of classified end-product pricing and pooling on processing investment, dairy product innovation and competition.

Dairy Export Incentive Program

For more information: (http://www.fas.usda.gov/exportprograms.asp)

The Dairy Export Incentive Program (DEIP) helps exporters of U.S. dairy products make sales to foreign buyers when US prices exceed prevailing world prices for targeted dairy products and destinations. As part of its World Trade Organization commitments resulting from the Uruguay Round Agreement on Agriculture, annual export subsidy ceilings are set for each commodity. These define maximum quantities and maximum budgetary expenditures, which are charged against the U.S. constrained subsidies under the WTO agreement. Private companies, not the U.S. government, make all sales under the DEIP.

USDA issues two types of bonus invitations: those inviting exporters to compete for a bonus, and those inviting exporters to apply for an announced bonus. When USDA issues an invitation for offers, agricultural exporters negotiate a sales contract with prospective buyers in eligible countries. The sale may be contingent on USDA's approval of a bonus. Each prospective exporter submits requests to USDA suggesting a bonus that would allow sales to take place at the agreed price. USDA chooses which bonuses to award.

Under an announced bonus, requests meeting all program requirements are accepted in the order submitted. USDA has the right to reject any or all bids.

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

USDA has limited the use DEIP to be consistent with WTO agreements that to instances when US prices are above prices in international markets and the claim that we are countervailing other countries' subsidies is plausible. In recent years, U.S. and "world" dairy commodity prices have been closely aligned or the U.S. price has been below prices in competing countries; hence, the economic and legal justification for an export subsidy has been weak. Moreover, the EU has reduced its dairy export subsidies as part of its agricultural policy, diminishing arguments that the U.S. is offsetting other countries' subsidies. The EU did resume export subsidies following price supporting actions it took during 2009, but maintains its longer term commitment to dismantling dairy industry support programs.

In addition to DEIP, other FAS programs are intended to enable or assist U.S. agricultural and food exports. These range from export promotion activities (such as trade shows, tours and visits) to programs that facilitate commercial transactions. Many agricultural businesses use export credit guarantees for commercial financing of U.S. agricultural exports.

Use of DEIP or other export assistance as a countercyclical measure to reduce dairy price volatility is limited by the requirements that U.S. prices be above world prices and/or the existence of evidence that other countries are providing export subsidies. However, before the Secretary takes more extreme measures, such as raising support prices, he or she should exhaust all possible DEIP options.

Risk Management Programs

Dairy farmers may use public or private programs to manage risk. Farmers, without government assistance, can hedge milk or input prices using futures and options contracts on traded exchanges. In addition, depending on location, some farmers can forward contract milk with dairy cooperatives and other buyers. This choice is not available to farmers in California because no permitted forward contracting mechanism exists within the structure of state-regulated milk pricing system there. Farmers can also forward contract some inputs, mainly feed, with suppliers.

Some concerns limit the use of risk management tools. Futures contracts may be contractst thed in unit sizes that are not easy for small producers to use on their own. Also, some hedging tools require y for gement tools. ward contract milk with dairy cooperatives and other buyers. This choice is not avaalls are designed to make sure that those with positions in the futures market are able to meet their financial obligations under their contracts. Margin requirements can tie up a significant amount of cash in a dairy operation.

USDAsh in a dairy opnt Agency (RMA) offers two risk management tools that are designed to help farmers by matching the size of contracts to farmers' needs. One is designed specifically for dairy farmers and is called Livestock Gross Margin - Dairy, or LGM-Dairy. Another is a program available for any type of farm called Adjusted Gross Revenue Lite or AGR-Lite.

Livestock Gross Margin (LGM) Dairy

LGM-Dairy, introduced in 2007, is a bundled hedging tool that provides protection to dairy producers for the difference between feed casts and milk prices. Rather than having to hedge milk prices and feed prices separately, LGM-Dairy establishes a floor on gross margins (milk price minus feed costs) and pays an indemnity if the margin falls below the established floor. The farmer chooses how much of his or her milk to cover and the month of the coverage. Premiums are based on expected milk revenue and expected feed costs that are calculated using futures market prices on Class III milk, corn and soybean meal at the time the insurance is purchased. While any given farmer's milk revenue or feed costs will not equal the futures prices on the Chicago Mercantile Exchange (CME), his or her margin changes are expected to correlate closely enough to CME price movements to make the tool useful for reducing risk.

Unlike futures contracts, LGM-Dairy does not require a minimum amount of milk. Producers may sign up for this program monthly and may choose to cover up to ten months of production at a time. Farmers may not purchase insurance for margins on more than 24 million pounds of milk over that period.

Recently, the Risk Management Agency announced several changes to how they would administer LGM-Dairy. The new LGM-Dairy uses a different procedure for calculating milk returns over feed costs that may correlate more closely with farmers' actual margins. The new program also encourages producer participation by providing a subsidy to lower the premium costs for farmers.

Adjusted Gross Revenue Lite (AGR Lite)

In 1998, RMA developed a new insurance product intended for all farmers and based on adjusted gross income (AGI) as reported on Schedule F of the farm business's taxes. The program combined protection from production losses related to natural causes with output price declines or input price increases related to market fluctuations. The product became quite complex and was difficult to use. AGR-Lite was developed in 2002 to provide a simpler tool that would have the same goal.

Any farmer can use AGR-Lite and the revenue protection applies to the whole farm, not one product. Premiums are lower for farmers who sell more products because their expected total margin risk is reduced by that diversity.

Participation rules are not particularly conducive to dairy production. No more than 35% of farm income can come from animals or animal products. Milk marketings are limited to 1.6 million pounds. The program only calculates costs of feed that is purchased, not feed that is grown. Total farm liability cannot exceed $1 million and gross income must be below $2,051,282.

Farmers select the coverage percentage of their total adjusted gross income and the percentage of the difference that they can receive if their actual AGI is less than the income coverage that was determined for them. The maximum income coverage is based on each producer's average AGI over the previous five years.

Use and Participation in LGM-Dairy and AGR-Lite

Although they are similar, the LGM-Dairy and AGR-Lite approaches to income protection differ beyond the fact that one is tailored to dairy and the other is designed for diversified farming operations. LGM-Dairy works on the basis of a price spread, the difference between the price of milk and the cost of feed expressed relative to an amount of milk produced. The resulting margin is expressed in $/cwt. AGR-Lite is based on the concept of income less production expenses, where both vary with the amount of milk produced (and other agricultural sales) and the amount of feed (and other production inputs) purchased.

Few dairy farmers have participated in either of these programs. Several factors explain this lack of participation. Size limits, market conditions, and program design and targets all contribute to their low participation by dairy farmers.

This Committee recommends an examination and overhaul of these programs in order to make them easier for dairy farmers to use. Current feedback from the farm community is that these programs are much too complicated and involve too much paperwork. The limiting factors described above should also be addressed in order to develop these programs into valid risk management tools for dairymen.

CCC Charter Act, Section 5

The Commodity Credit Corporation (CCC) was created in 1933 to handle commercial transactions that involve agricultural commodities. It is the business vehicle through which various programs stabilize, support, and protect farm income and prices. CCC also facilitates the movement of surplus or other agricultural commodities to various government and non-governmental outlets.

The Commodity Credit Corporation Charter Act of 1948 establishes the general purpose of the CCC and its operating rules and authorities. Section 5 of the Act, excerpted below, grants authorities to acquire and disburse agricultural commodities.

> *SEC. 5. [15 U.S.C. 714]*
>
> *SPECIFIC POWERS.—In the fulfillment of its purposes and in carrying out its annual budget programs submitted to and approved by the Congress pursuant to Chapter 91 of Title 31, the Corporation is authorized to use its general powers only to —*
>
> *(a) Support the prices of agricultural commodities (other than tobacco) through loans, purchases, payments, and other operations.*
>
> *(b) Make available materials and facilities required in connection with the production and marketing of agricultural commodities (other than tobacco).*
>
> *(c) Procure agricultural commodities (other than tobacco) for sale to other Government agencies, foreign governments, and domestic, foreign, or international relief or rehabilitation agencies, and to meet domestic requirements.*
>
> *(d) Remove and dispose of or aid in the removal or disposition of surplus agricultural commodities (other than tobacco).*
>
> *(e) Increase the domestic consumption of agricultural commodities (other than tobacco) by expanding or aiding in the expansion of domestic markets or by developing or aiding in the development of new and additional markets, marketing facilities, and uses for such commodities.*
>
> *(f) Export or cause to be exported, or aid in the development of foreign markets for, agricultural commodities (other than tobacco) (including fish and fish products, without regard to whether such fish are harvested in aquacultural operations).*

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

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

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

This Section of the legislation defines a number of things that the CCC may do; however, this is different from what is actually possible or required. These general authorities enable the Secretary of Agriculture to implement the procurement and sale of dairy products under the DPPSP and various other programs related to domestic and international food assistance.[2]

If no specific program requires the Secretary to procure and/or distribute dairy or other commodities, he could use the provisions of this Charter to do so if and only if there is a source of funds authorized by the Office of Management and Budget. Many of the programs that use the CCC as a conduit are described in the next two sections.

Domestic Food Assistance Programs

For more information: (http://www.fns.usda.gov/fns/)

The majority of the budget of the US Department of Agriculture, about two-thirds, is devoted to food and nutrition programs. These programs are generally administered through the Food and Nutrition Service and include the following:

1. Supplemental Nutrition Assistance Program (SNAP, formerly Food Stamps)
2. Special Supplemental Nutrition Programs for Women, Infants, and Children (WIC)

[2] The CCC is managed by a Board of Directors, subject to the general supervision and direction of the Secretary of Agriculture, who is an ex-officio director and chairperson of the Board.

3. School Meals
    a. National School Lunch
    b. Fresh Fruit and Vegetable Program
    c. School Breakfast Program
    d. Special Milk Program
    e. Team Nutrition
4. Summer Food Service Program
5. Child and Adult Care Food Program
6. Food Assistance for Disaster Relief
7. Food Distribution
    a. Schools/Child Nutrition Commodity Programs (CNP)
    b. Food Distribution Program on Indian Reservations
    c. Nutrition Services Incentive Programs (NSIP)
    d. The Commodity Supplemental Food Program (CSFP)
    e. The Emergency Food Assistance Program (TEFAP)

Only the Special Milk Program is exclusive to dairy products, but many of these programs have played a significant role in increasing the availability and use of dairy products among children and the needy. The Special Milk Program provides cash subsidies to schools for milk they serve to children not covered under the School Lunch and similar programs.

USDA provides grants to states, which in turn deliver WIC program benefits to pregnant women, women with young children and those infants and young children. Historically, WIC has had a strong emphasis on providing milk and other nutritious dairy products to these people..

TEFAP was originally started during the early 1980s when surpluses under the DPSP became burdensome. Many elderly and other needy US citizens benefitted from donations of surplus cheese and butter. The success of the Temporary Emergency Food Assistance Program led to the creation of The Emergency Food Assistance Program. Today, TEFAP is the primary vehicle for distributing commodity foods to states that, in turn, distribute food to food banks and similar local food distribution agencies.

Each of these programs can be a vehicle for the use and distribution of dairy foods. However, several factors limit their effectiveness as a short term response to a dairy surplus.

First, these programs are budgeted. Increased dairy purchases would supplant other food products. USDA may shift funding among various commodities, but many non-dairy foods have legitimate claims on available funds.

Second, these programs require planning, implementation, and execution. Programs that coordinate with state-run activities are subject to the timing, planning and discretion of the receiving state. Programs in which USDA works directly with an agency typically involve a spending and utilization plan of that agency. Schools, in particular, plan their budgets and menus early. Once in place, these plans are not often changed.

Third, the amount of dairy products that can be used and provided to these programs on a timely basis is limited. For example, storage space and refrigerator capacity to minimize spoilage are limited. In addition, since dairy processors must continue to service existing customers or risk losing their customer base, they cannot divert unlimited quantities to food assistance outlets.

Finally, increased use of dairy products in food assistance programs may substitute for commercial sales if recipients substitute the additional dairy products that they receive for dairy products that they would normally purchase through commercial channels. If this occurs, total utilization of dairy products does not increase and dairy producers don't benefit.

Congress can create funding and programs to respond to something like the dairy crisis of 2009, but once funding for food and nutrition programs are established the Secretary cannot easily alter the plan or find additional funding to support one specific agricultural or food sector.

International Food Assistance Programs

Several programs provide food to needy people in low-income countries on an ongoing basis or to provide emergency assistance in times of natural or other specific disaster. These include:

A. Food for Peace
B. McGovern-Dole
C. Food for Progress
D. Section 416(b)

Food for Peace (FPA) was authorized under the Agricultural Trade Development and Assistance Act of 1954. At first considered a temporary response to deal with agricultural surpluses, this program has evolved to become an pillar of U.S. food assistance, considered a core program by advocates for low income countries. The FPA has three titles, each with a specific objective and providing assistance to countries at a particular level of economic development. Title I is administered by USDA. Titles II and III are administered by the U.S. Agency for International Development (USAID). USAID is an independent federal agency that operates under the supervision of the Secretary of State.

For more information: (http://www.fas.usda.gov/excredits/FoodAid/pl480/pl480.asp)

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

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

FPA, Title II–Emergency and Private Assistance, provides for the donation of U.S. agricultural commodities to meet emergency and non-emergency food needs in other countries.

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

Although the Secretary of Agriculture is responsible for Title I uses of agricultural commodities, he or she needs funding in order to act. In recent years, advocates for international food assistance have urged Congress to provide direct cash subsidies that would allow foreign governments or approved agencies in foreign countries to buy food wherever they can find it most cheaply. While this approach enables the most total food assistance per dollar spent, it may not provide much support for U.S. agriculture.

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

Commodities are donated through agreements with private organizations, cooperatives, intergovernmental organizations and foreign governments. Commodities may be donated for direct feeding or, in limited situations, for local sale to generate proceeds to support school feeding and nutrition projects.

Under the Food for Progress Act of 1985, agricultural commodities are provided to developing countries and emerging democracies that are committed to introducing and expanding free enterprise in the agricultural sector. Commodities are currently donated to foreign governments, private voluntary organizations, nonprofit organizations, cooperatives, or intergovernmental organizations.

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

Section 416(b) of the Agricultural Act of 1949, as amended, provides for overseas donations of surplus commodities acquired by the CCC. Donations are not permitted to reduce the amounts of commodities that are traditionally donated to U.S. domestic feeding programs or agencies or disrupt normal commercial sales.

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

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

The assortment of foreign food export programs provides opportunities for the U.S. government to increase use of dairy products. However, that authority is tempered by budgetary constraints and by concerns that the dispositions not be disruptive to recipient country economies or of world trade in dairy products.

Section 32, Public Law 74-320

In 1935, as part of its response to the hardship for agriculture during the Great Depression, Congress created a permanent authority to give USDA money from U.S. customs receipts (tarriffs) to support farmers whose products were not otherwise covered or protected by more specific commodity policy. The Secretary has discretion in how to use Section 32 funds. The following is from a Congressional Research Service report written in 2006:

> *Section 32 of the act of August 24, 1935, authorizes a permanent appropriation equal to 30% of annual U.S. customs receipts (P.L. 74-320 as amended; 7 U.S.C. 612c). This money was first available to assist Depression-era producers of non-price-supported commodities. Section 32 funds, along with up to $500 million in any unobligated prior year funds, are to be used for (1) encouraging the export of farm products through producer payments or other means; (2) encouraging the domestic consumption of farm products by diverting surpluses from normal channels or increasing their use by low income groups; and (3) reestablishing farmers' purchasing power. The Secretary of Agriculture has considerable discretion in deciding how to achieve these broad objectives.*
>
> *.....Today [viz. 2006], most of this appropriation (now approximately $6.5 billion yearly) is transferred to the U.S. Department of Agriculture (USDA) account that funds child nutrition programs. Other Section 32 funds are used by USDA to purchase meats, poultry, fruits, vegetables, and fish, which are diverted mainly to school lunch and other domestic food programs. Several times in recent years, the Secretary of Agriculture also has drawn substantial amounts from Section 32 to pay for special farm disaster relief.*

This has added to the debate over how much flexibility the Secretary should have over use of the reserve, and whether the disaster aid has or could come at the expense of the other Section 32 activities.

Excerpted from: Farm and Food Support Under USDA's Section 32 Program, by Geoffrey S. Becker; Specialist in Agricultural Policy; Resources, Science, and Industry Division; Congressional Resource Service; RS20235; 28 November 2006

Because the Dairy Price Support Program and Milk Income Loss Contract Program specifically assisted the dairy sector, Section 32 funds could not be used to purchase or distribute dairy products. With the evolution of the DPSP into the DPPSP in 2008, an argument could be made that government support has now been legally restricted to commodity packaged butter, nonfat dry milk and cheddar cheese. Under this interpretation, Section 32 funds could support other dairy products, such as mozzarella cheese, fluid milk, or whey protein concentrate.

Section 32 does not create a program, it creates a fund of money. Thus, this money could be used in conjunction with existing programs that are designed for domestic food assistance, international exports or food aid. The legislative language "reestablishing farmer's purchasing power" suggests an even broader authority to, for example, compensate producers for losses caused by low prices. However, it is unclear whether Section 32 funds could legally be used to benefit the dairy sector since, even with the change in the DPSP, other programs, such as MILC, are specifically designed for dairy.

Farm Loan Programs

USDA's farm loan program operates under the authority of the Consolidated Farm and Rural Development Act (7 U.S.C. 1936) and is administered by USDA's Farm Service Agency (FSA). FSA makes direct and guaranteed farm ownership and operating loans to qualified and eligible farmers and ranchers who cannot obtain commercial credit from a bank, Farm Credit System institution, or other lender. FSA loans can be used to purchase land, livestock, equipment, feed, seed, and supplies. Loans can also be used to construct buildings or make farm improvements. FSA employs farm loan officers who originate and service Direct Farm Ownership and Operating Loans. FSA works with banks and Farm Credit System institutions, providing guarantees on loans originated and serviced by those commercial lenders.

The USDA-FSA Farm Loan Program (FLP) is an important source of credit to dairy producers. FLP provides direct loans, guarantees on loans originated through commercial banks or Farm Credit System associations, and interest assistance on operating lines of credit, as well as emergency loans in situations where farmers have been adversely impacted by severe weather conditions. FLP targets a significant portion of its funds to beginning farmers: 50% of Direct Operating, 40% of Guaranteed Operating, 75% of Direct Farm Ownership, and 40% of Guaranteed Farm Ownership. In addition to targeting beginning farmers, each state FSA FLP targets a percentage of their loan funds to Socially Disadvantaged Farmers based on state demographics.

In fiscal year (FY) 2010, \$6.115 billion was appropriated for the FLP. As of September 3, 2010, the FLP had 33,541 loans in its national portfolio for a total of \$4.913 billion. The maximum principal amount per borrower in direct loans is $300,000. The maximum total principal amount for direct loans plus loan guarantees is $1,119,000. This amount is adjusted annually based on inflation.

Approximately 52% of the loans in the FLP portfolio were Direct Operating Loans typically used for purchase of cattle, machinery, building construction, or other farm improvements. An additional 20% were Guaranteed Operating Loans originated and serviced by commercial lenders. Direct Farm Ownership Loans and Guaranteed Farm Ownership Loans used for purchase of farm real estate each accounted for 12% of the loans in the portfolio.

The top five states in FY 2009/10 in terms of number of new loan applications are listed below. New direct and guarantee loan volumes for the first eleven months of the fiscal year are in parenthesis.

1. Wisconsin ($419 million)
2. Minnesota ($309 million)
3. Iowa ($286 million)
4. Texas ($220 million)
5. Nebraska ($235 million)

Wisconsin FSA FLP Example

As Wisconsin is the largest customer of the Farm Loan Program, with by far the majority of its loans procured by dairy producers, we provide here a closer look at Wisconsin's successful use of the program.

The Wisconsin FSA FLP portfolio crossed the $1 billion threshold in early 2010. As of August 31, 2010, it held 4,956 loans for a total of $1.24 billion. Of these, 62% were direct loans and 38% were loan guarantees. Approximately 90% of FLP borrowers in Wisconsin are dairy producers.

The FSA FLP has, for many years, been an important source of credit for Wisconsin dairy producers. Wisconsin FSA FLP has historically been one of the top three among all states in both the number and the dollar volume of loans. FSA FLP has loan program managers assigned to cover every county in the state. They do an excellent job of outreach to farmers. They partner with many other entities that can help them more effectively serve farmers including the Wisconsin Department of Agriculture, Trade and Consumer Protection, Wisconsin Technical College System, University of Wisconsin School for Beginning Dairy and Livestock Farmers, and others. FSA has developed strong working relationships with commercial agricultural lenders to broaden the scope of its loan guarantee and interest assistance programs. In short, there are few agricultural borrowers or lenders in Wisconsin that are not aware of the FSA FLP.

As commercial agricultural credit became more difficult to obtain in 2009, the importance of the Wisconsin FSA FLP became even more pronounced. Lenders pointed many borrowers towards the FLP, and FLP loan volume in the state increased dramatically.

There are some key reasons that the FSA FLP works well in Wisconsin:

Wisconsin FLP has a high participation in the Preferred Lender Program (PLP) which allows experienced agricultural lenders to quickly obtain USDA Loan Guarantees with a minimal amount of paperwork. Subsequent review by state FSA FLP staff allows the private lender to conduct their business with minimal disruption of their normal operating procedures. FSA FLP monitors the aggregate performance of each lender rather than each individual loan application. Lenders with strong records of success maintain PLP status; those with higher losses are more closely scrutinized. (Many states have struggled to implement these loan guarantee processes.)

Wisconsin FSA FLP views itself as a partner with private agricultural lenders, and the lenders look at FSA FLP in that way as well. In many cases, the private lender has part of the financing package and FSA has part of the financing package. It is not an "either, or" situation.

Wisconsin FSA FLP contracts out to the private sector for many services such as real estate and chattel appraisals that assist their loan officers, which allows them to focus on the duties that only they can do. In the past, FSA FLP loan officers would have done these tasks. By contracting out for these services, FSA FLP has freed up its loan officers to serve new loan applicants and service their existing loan portfolios. This has allowed Wisconsin FSA FLP to be a national leader in loan-making, while keeping delinquencies and losses among the lowest in the nation. Wisconsin FSA FLP has centralized its loan liquidation process in the state office, which also frees up field loan staff to make and service more loans.

Despite maintaining a large loan portfolio with borrowers who were unable to obtain commercial credit, Wisconsin FSA FLP has experienced relatively low delinquency rates. In FY 2009/10, approximately 1.93% of the direct loan portfolio and 0.88% of the guaranteed loan portfolio was delinquent. By commercial lending standards, these delinquency rates are relatively low, particularly considering the poor economic conditions in the dairy industry during the period.

On a national level, Secretary Vilsack issued a letter at the height of the 2009 dairy crisis to all of FSA's dairy producer-borrowers informing them of the loan servicing options available to alleviate financial stress. These options included lifting milk check assignments to allow money to flow through for family living and operating expenses, deferring principal and interest payments, lowering payments through rescheduling or re-amortizing of debt, and other options. Many FLP borrowers contacted their loan managers to take advantage of the relief that was available.

Apparently, certain geographies leveraged the Farm Loan Programs more effectively than others. We recommend that FSA examine these disparities and develop strategies to share best practices across regions.

Market News, Research, and Promotion Programs

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

These programs typically provide valuable information for buyers and sellers in dairy markets. While valuable for the long term profitability of the dairy industry, the programs cannot be easily used for short term benefits.

The Office of Management and Budget

The Secretary of Agriculture can only initiate and operate programs 1) which he is authorized to administer and 2) which have a well-defined mandatory or discretionary source of funding. If the program is mandatory, Congress provides authority to spend whatever money is required to achieve the purposes of the Act. If the program is discretionary, Congress may or may not provide funding to support the program. When funding is limited, which of course is the general rule, the Office of Management and Budget plays a crucial role in determining what can and what may be done.

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

The Mission and Structure of the Office of Management and Budget

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

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

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

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

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

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

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

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

OMB has significant influence on the spending ability of any federal agency, including USDA. When Congress has provided a clear mandate and sufficient funding to conduct a program, OMB's primary concern is the efficient execution of the required program. However, when an authorized program is unfunded or underfunded the Secretary must work with OMB to determine where funding might be available or even whether any such funding can be found. Inasmuch as OMB reports to the President, OMB's priorities, both programmatically and from the standpoint of financial stewardship, are driven by the President's overarching priorities. In periods when budgets are tight, OMB tows a hard line on discretionary spending. Even when budgets have some slack, OMB will and must evaluate tradeoffs when an Executive agency, like USDA, makes a request.

Recommendations for the Use of Existing Programs

Farm Loan Programs

All state FSA Executive Directors and State Committee members, particularly those in states with significant numbers of dairy operations, should make promotion of the FLP a high priority. We encourage states to undertake more aggressive outreach efforts to increase awareness of the FLP among producers and lenders.

The definition of a "family farm" for purposes of extending credit under the FLP should be interpreted consistently in all states. Approximately 95% of the dairy operations in the United States are milking fewer than 500 cows. Most of those would meet the FLP definition of a family farm and would find the FLP to be a very beneficial source of credit during times when access to commercial credit is limited.

All state FLPs could extend the scope of their Guaranteed Loan Programs by building effective Preferred Lender Programs (PLP). PLPs make it much easier for commercial lenders to use FLP

Guarantees. PLPs make more efficient use of state FLP staff time by minimizing the loan processing involved in each guarantee.

Dairy industry stakeholders across the country should take the initiative to learn more about the federal loan programs available to producers and other agriculture-related businesses in their states. In addition to the FSA FLP, other federal agencies such as USDA Rural Development and the Small Business Administration have loan programs that may be helpful to dairy producers.

We recognize the critical importance of the FLP to our nation's dairy producers, especially when economic conditions make commercial credit difficult to obtain. The remarkably low default rate experienced in the FLP shows that funds invested in the program will be used wisely and will recirculate to provide help to even more farmers. We appreciate the Secretary's and Congress' work in providing additional funds for the FLP during the 2009 dairy crisis. We encourage the Secretary to also provide adequate staffing for the FLP. State FSA Executive Directors should be given the discretionary authority to temporarily re-assign county-level staff from commodity programs to the FLP during times of high loan demand. FSA Executive Directors should also be given the ability to temporarily hire assistance, such as experienced, retired commercial agricultural lenders to provide support to FLP staff during periods of strong demand. To achieve maximum efficiency of FSA staff, USDA could encourage state FSA offices to consider contracting out to the private sector for items like real estate and chattel appraisals.

Federal Milk Marketing Orders

Although FMMOs provide some valuable services to the dairy sector, their use of end-product pricing and pooling raise concerns. The Committee recommends further work by USDA or some other entity to analyze the operations of the FMMO system, including, but not limited to, end-product pricing's impact on milk price volatility and impact of classified pricing and pooling on processing investment, competition and dairy product innovation. The committee feels that these are critical issues for addressing our charge, but that we have not been given sufficient resources or time so far to fully evaluate market order administration within the current legislative context and make more specific recommendations. Some of the important changes may require Congress to act.

Develop Industry Margin Measurement

The Committee recommends that USDA implement a data gathering and reporting system that expresses the degree of distress in the dairy industry at any given time. The resulting index would provide an impartial overview of the general level of profitability at the farm level. We suggest using a milk price-feed cost margin calculation as a methodology for this index. While this index would not be representative of the profitability on individual dairy farms, it would serve as a better reflection of farm-level economic health than current milk-price-only measurements do.

USDA should then determine levels of dairy farm margin under this measure that indicate two levels of dairy farm distress that can be used as triggers for possible government intervention. The first trigger should be at a level that causes concern over the sustainability of the U.S. dairy sector. The second should indicate extreme distress such as that experienced in 2009. The advantage of a trigger is that the industry has more certainty about when or under what conditions the Secretary could take action. The trigger approach has the benefit of reducing market risk.

Countercyclical Interventions

Countercyclical payments (CCPs) are subsidies paid by the government to offset or partially compensate for periods of low prices. As such, they differ from disaster payments, which tend to relate to crop failures, not low prices. Hypothetically, a CCP could be triggered by a low price, a low margin, or by some other event that is determined to be more of an emergency or something unpredicted, apart from normal cycles. Regardless of the specific measure or triggering rule, the countercyclical concept could be expanded to dairy programs.

Barring legislative changes, the programs which permit the Secretary some flexibility in their application as emergency measures in times of critically low farm margins are the Dairy Product Price Support Program and one or more food assistance programs. If the Secretary can identify sources of funding, he could stimulate demand and thereby lift prices via either of these approaches.

Because movements of the DPPSP purchase prices disrupt commodity financial markets and the financial positions of farmers and others who have chosen to mitigate risk through those markets, as well as U.S. export markets, we suggest prioritizing food assistance programs over increasing DPPSP levels.

When dairy farm margins, as measured by the aforementioned margin measurement, decrease to the first trigger level, and all options offered under DEIP have been exhausted, this Committee recommends that the Secretary guide food assistance purchases toward additional dairy products.. USDA would temporarily be creating new demand for dairy products which would exert upward pressure on dairy product prices and, therefore, farm level milk prices. The Secretary should ensure that government purchased dairy foods donations do not significantly displace commercial sales. Therefore, dairy foods should be provided to people who would not otherwise purchase them.

If dairy farm margin levels decrease to the second trigger level, only then would the Secretary increase the purchase prices under the DPPSP to levels which provide more revenue for dairy farmers. In the case of the DPPSP, extra demand would come from government purchases that aim to move cheese, butter, and/or nonfat dry milk off of the commercial market.

When the margin measurement methodology has been determined, appropriate margin trigger level(s) identified, and the corresponding DPPSP price level increases that would occur at those trigger levels set, those details should be published by USDA. That way, potential future government interventions, such as increases in the DPPSP, can be considered and included in dairy farmers' personal milk marketing and business decisions. Uncertainty around government intervention may tend to discourage farmers from protecting their own margin risk because of varying expectations around intervention.

Although the triggers provide a justification and a guide, the Secretary should maintain discretion as to whether to implement these measures. He should determine that conditions are a result of extraordinary shocks rather than predictable cyclical price swings. He should also develop standards that assure that the measures do not significantly or unavoidably harm export markets or commercial channels.

The Secretary should apply both of these approaches judiciously and rarely. If these approaches are used too frequently, they lose their effectiveness. We do not intend to indicate that this Committee supports continuation of the DPPSP. We merely intend to provide a framework around which the Secretary's existing authority should be applied.

Risk Management Programs

This Committee recommends an examination and overhaul of both LGM-Dairy and AGR-Lite in order to make them more accessible and easier for dairy farmers to use. Farmers have expressed that these programs are much too complicated and involve too much paperwork. The issues driving lack of participation should be addressed in order to develop these programs into valid risk management tools for dairymen.

In addition, these programs would greatly benefit dairy farmers if they could, in addition to providing risk management mechanisms, provide comprehensive education on risk management. Because volatility in the dairy industry is a relatively new experience (less than 20 years) for many farmers, it is understandable that farmers are unsure of whether or how to manage their own risk. USDA risk management programs could provide a valuable tool to dairy farmers simply by providing that education, regardless of the actual risk management tools used.

Comments on Possible Unintended Consequences

One of the inherent challenges in any public policy is that few choices make everyone better off. The political and policy worlds necessarily involve tradeoffs, which exist in the dairy sector among producers and among dairy processors, retailers, consumers, taxpayers, and alternative agricultural or food sectors. This committee has been charged with addressing dairy farm profitability and milk price volatility. This puts our focus on the farm sector, but downstream effects constrain any dairy policy debate. We do recognize that even those policies which are good for some dairy farmers are not good for all dairy farmers.

We also recognize that the Secretary has a responsibility to balance and represent a public interest in the administration of USDA programs and acknowledge that achieving that balance is a difficult task. Programs aimed at assisting farmers by excessive artificial enhancement of price can constrain sales, be contrary to the interests of consumers and, in fact, even contrary to the interest of some dairy farmers. The purpose of the policies discussed here is to counter excessive market conditions, but not to eliminate fundamental market functions.

In Conclusion

Numerous programs can be used to benefit dairy farmers and the dairy sector in times of stress. This include programs to directly support prices or farm incomes and programs that more indirectly affect the demand for dairy products and thereby strengthen markets and prices.

In theory, all of these programs could be extremely helpful in times of economic stress, but in practice, these programs are not well suited to unanticipated stress and quick responses to emergency conditions. In many cases, the Secretary of Agriculture has no authority to change a program or operate it outside of a very narrow range of legislatively defined parameters. In some cases, the law grants the Secretary some discretion in defining a program's parameters, but when the Secretary's decisions have an impact on government expenditures, he or she must get approval from the President's Office of

Management and Budget. Since its creation in 1922, this office has played the role of budget watchdog. While the specific economic policies and priorities of Presidents certainly change over time, OMB's job is to carefully and cautiously steward the resources Congress provides to the Executive Branch. Obtaining permission to use discretionary authority for agricultural programs in general and dairy in particular can prove difficult.

The specific topics of dairy farm profitability and milk price volatility continue to be studied by the DIAC. The recommendations presented here are framed from the perspective of the DIAC charge only as it relates to current authorities. A further report will include recommendations for removing, adding or changing federal programs in order to provide a more comprehensive and long-lasting positive impact on dairy farm profitability and margin volatility than what is offered by current authority.

###

Appendix

Summary of Dairy Product Price Support Program (DPPSP)
Objectives: Price Support - prevent farm price of milk from falling below a target level by purchasing dairy commodities specified by Congress at specified minimum prices. The underlying objective is variously described as to create greater price stability or to enhance farm prices and income. Minimize impact on commercial sales when disposing of government stocks
Methods: USDA/CCC offers to purchase butter, cheese, and nonfat dry milk, according to established specifications, at the announced purchase prices. If this price is appealing to manufacturers of those commodities, compared to prevailing or expected market prices, the manufacturer initiates a “response” to USDA’s “invitation. CCC takes ownership of the product and is expected to dispose of the product in a manner that recognizes its value as a food product but which does not undermine the commercial market for similar products. This may included domestic and international food assistance, use in government programs and facilities, use in animal feeds, and the like. If a product is offered for sale in commercial channels, its price must equal or exceed the established Sellback Price. Sellback Prices are currently 110% of purchase prices.
Legal Authority: Agricultural Act of 1949 (as amended)
Administering Agency: U.S. Department of Agriculture - Farm Services Agency Farm Programs - Price Support Division Commodity Operations - Commodity Credit Corporation

Summary of the Milk Income Loss Contract (MILC)
Objectives: Income Support - augment dairy farmer income when milk prices are low
Methods: Provide a countercyclical payment to qualified dairy farmers when the Class I price announced for the Boston city zone of the Northeast Federal Milk Marketing Order falls below a legislatively-specified value. In addition to setting the benchmark or target price, the law also specifies a percentage of the difference between the target price and the announced price. The payment rate is based on that percentage. Total payments are limited to a specified amount of milk marketings (pounds of milk sold) per farm. In each marketing year, qualified dairy farmers must elect the month in which they are first eligible to begin receiving a monthly MILC supplement. Payments are made in each consecutive month in which a payment is due until the annual limit on marketings is reached.
Legal Authority: Food, Conservation and Energy Act of 2008 (FCEA). The MILC was first authorized under the Farm Security Act of 2002 (FSA). But, its legislative origin traces to emergency market transition assistance authorized under the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 2000 (H.R.1906).
Administering Agency: U.S. Department of Agriculture - Farm Services Agency Farm Programs - Price Support Division

Summary of Federal Milk Marketing Orders (FMMO)
Objectives: Orderly marketing (not specifically defined) Adequate supplies of milk for fluid purposes
Methods: Classification of producer milk according to the product in which it is used and minimum pricing of milk according to class Pooling the values paid by processors for each class of milk to return a common "pool" price to all producers, regardless of the actual destination of their milk Auditing to ensure and enforce compliance by regulated handlers
Legal Authority: Agricultural Marketing Agreement Act of 1937 (as amended)
Administering Agency: U.S. Department of Agriculture - Agricultural Marketing Service - Dairy Programs

Summary of the Dairy Export Incentive Program (DEIP)
Objectives: Increase sales of US dairy products in foreign markets, particularly to offset export subsidies from other countries Encourage dairy product marketers to export
Methods: Provide cash subsidies to dairy product exporters by supplementing privately negotiated export prices.
Legal Authority: Created under the Dairy Production Stabilization Act of 1983 and initiated in May 1985. Reauthorized under the Agriculture, Conservation, and Trade Act of 1990, the Uruguay Round Agreements Act of 1995, and the Federal Agriculture Improvement and Reform Act of 1996.
Administering Agency: U.S. Department of Agriculture - Foreign Agricultural Service