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Dairy Provisions of the Enacted 1996 Farm Bill

(name redacted)

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Summary

The Federal Agriculture Improvement and Reform Act of 1996 (P.L. 104-127, the enacted 1996 farm bill) contains provisions (Title I, Subtitle D, Chapter 1) that significantly modify the two major federal policy tools used to support milk markets: the dairy price support program and federal milk marketing orders. The new law reduces the level of price support under the dairy price support program in each year (1997 through 1999), until the program is terminated at the end of 1999. In return, the deficit reduction assessment paid by milk producers is eliminated almost immediately. The dairy price support program is replaced on January 1, 2000 by a recourse loan program for dairy processors to assist them in managing their inventories. The enacted 1996 farm bill requires a reduction in the number of milk marketing orders, to at least 10 but no more than 14 -- and gives USDA three years to administratively achieve this goal.

Other dairy provisions in the 1996 law: 1) give the New England states temporary authority to enter into a regional dairy compact, pending a USDA determination that there is a compelling public interest in a compact; 2) allow California to retain its minimum nonfat solids standards for fluid milk at its current level; 3) establish a maximum manufacturing allowance for states; 4) extend the authority for the processor-funded promotion program through 2002; and 5) fully fund the dairy export incentive program at the maximum level allowed under the Uruguay Round agreement.

Dairy Price Support Program

The dairy price support program 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. Per-pound prices paid to the processors for Government purchases of cheese, butter, and nonfat dry milk are set administratively at a level that will permit processors to pay dairy farmers at least the federal support price for their milk.

Section 141 of the enacted 1996 farm bill reauthorizes the dairy price support program, including USDA authority to purchase surplus cheese, butter, and nonfat dry milk. The level of support is maintained at the current level of \$10.35 per hundredweight (cwt.) for the remainder of 1996, but then drops to \$10.20 in 1997, \$10.05 in 1998, and \$9.90 in 1999. The program terminates on December 31, 1999. As under previous law, the Secretary of Agriculture is given the authority to adjust twice annually the mix of prices it pays for surplus butter and nonfat dry milk so that federal outlays can be minimized.

Deficit Reduction Assessment

As part of the 5-year federal deficit reduction agreement enacted in 1990, the Omnibus Budget Reconciliation Act (OBRA) of 1990 (OBRA) required all milk producers to pay a 5 cent per hundredweight (cwt.) assessment on 1991 milk marketings, rising to 11.25 cents per cwt. annually from 1992 through 1995. The Omnibus Budget Reconciliation Act of 1993 extended the assessment through 1997, and reduced it to 10 cents per cwt. effective January 1, 1996. The purpose of the assessment was to defray the federal cost of the dairy price support program. Any producer whose total annual milk production is less in an assessment year than in the previous year is eligible for a refund of the assessment paid in the lower-production year.

To offset the impact of the lower level of price support and the gradual elimination of the program, section 141 of the enacted 1996 farm bill terminates the deficit reduction assessment, effective May 1, 1996. Assessments collected between January 1 and April 30, 1996 will be refunded to any producer who can provide evidence that 1996 milk production is below 1995 total production.

Recourse Loan Program

After the price support program expires, section 142 of the enacted 1996 farm bill authorizes a recourse loan program for commercial processors of cheese, butter and nonfat dry milk, effective January 1, 2000. Processors will be eligible for loans based on the 1999 support price of \$9.90 per cwt. The interest rate on the loan may not be any lower than USDA's cost of borrowing from the U.S. Treasury. Repayment of processor loans are due at the end of the fiscal year, unless the Secretary extends the loan until no later than the end of the next fiscal year. The recourse loan program is designed to assist processors in managing their inventories of dairy products.

Federal Milk Marketing Order Reform

In addition to the dairy price support program, farm prices for most milk are also governed by a complex system of federal milk marketing orders. Federal milk marketing orders regulate handlers that sell milk or milk products within an order region by requiring them to pay not less than an established minimum price 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 than for milk used in manufactured dairy products. The farm price of approximately three-fourths of the Nation's fluid milk is regulated under approximately 33 federal orders. Some states,

California for example, have their own milk marketing regulations, either instead of, or in addition to the federal rules. Unlike the dairy price support program, federal milk marketing orders are permanently authorized and therefore do not require periodic reauthorization.

Section 143 of the enacted 1996 farm bill requires a reduction in the number of milk marketing orders, to at least 10 but no more than 14 -- and gives USDA three years to administratively achieve this goal using informal rulemaking procedures. If at the end of three years, USDA has not completed the consolidation, the Department would lose its current authority of assessing producers and processors for the cost of administering milk marketing orders, and instead USDA would have to absorb the cost in its budget. If consolidation is delayed by a legal challenge, the three-year deadline given to USDA would be extended by the duration of any injunction. Section 143 also requires USDA to designate California as a separate federal order, if California milk producers request and approve the inclusion of the state in the federal order system.

The structure of federal milk marketing orders has long been the subject of policy debate. Producer groups in the Upper Midwest (Wisconsin and Minnesota) contend that federal orders are in need of reform, while many dairy processors contend that orders are market-distorting and should be gradually eliminated. Milk producer groups in the Northeast and Southeast generally support the current order system and maintain that any changes to the system should be handled administratively by USDA.

For more on federal milk marketing orders, see CRS Report 95-267, *Federal Milk Marketing Orders: Background and Current Policy Issues*.

Northeast Dairy Compact

The legislatures of the six New England states agreed to enter into a dairy compact that would create an interstate commission with the power to set a minimum price paid by dairy processors to dairy farmers in the New England states, at a level above the federal minimum price. However, any proposed interstate compact must first be approved by Congress, as required by the interstate commerce clause of the U.S. Constitution.

Section 147 of the 1996 farm bill gives the New England states the authority to enter into a regional dairy compact, pending a determination by the Secretary of Agriculture that there is a compelling public interest in a compact. The new law requires the compact to terminate at the same time as the adoption of federal milk marketing order consolidation.

The New England states sought approval for the compact because dairy farm groups in the region maintain that the minimum milk prices dictated by federal milk marketing orders are not sufficient to cover the costs of production of family-sized farms, thus forcing many farmers out of business. Opponents maintain that the compact would artificially encourage the production of milk within the Northeast region at the expense of other parts of the country that have lower production costs and can sell at lower prices.

Milk Manufacturing Marketing (Make) Allowance

The milk manufacturing marketing allowance, or "make allowance," is a significant factor in determining the Government purchase price for surplus dairy products under the price support program. When USDA calculates the purchase price that dairy processors receive for their surplus products, a make allowance is included to cover the processor's cost of manufacturing the product, so that manufacturers may pay producers at least the support price for their milk.

Section 102 of the Food, Agriculture, Conservation, and Trade Act of 1990 (P.L. 101-624, the 1990 farm bill) prohibited any state from setting its make allowance at a higher level than the federal allowance. Since USDA never finalized regulations for Section 102, the provision was never implemented. Although in theory this provision could affect any state that maintains a marketing order separate from the federal order system, in practice, only California, which is the largest milk-producing state, has established a higher make allowance. Critics of the California pricing system argue that the higher California allowance encourages manufacturing production in California, which in turn displaces manufacturing production in other regions of the country, particularly the Upper Midwest. Defenders of the California pricing system contend that processors in the state are faced with higher manufacturing costs than other dairy regions, and need the higher make allowance to ensure that California milk production can be processed in-state.

Section 145 of the enacted 1996 farm bill represents a compromise of these two positions. It repeals Section 102 of the 1990 farm bill, and instead prohibits any state from setting a make allowance that is higher than \$1.65 per cwt. for milk used in butter and nonfat dry milk production, and \$1.80 per cwt. for milk manufactured into cheese, effective May 1, 1996 through December 31, 1999. The current national make allowance levels are \$1.22 per cwt. for butter and nonfat dry milk, and \$1.37 per cwt. for cheese. If any state is found to be in violation of this section during the effective period, USDA must suspend the purchase of surplus products from that state until it is in compliance.

Nonfat Solids Standards

Section 144 of the enacted 1996 farm bill explicitly permits California to keep in place its higher nonfat solids standards for fluid milk, and leaves the national standards unchanged. The House Agriculture Committee-reported version of the farm bill would have increased the national minimum nonfat solids standards of fluid milk to the California level. The provision was deleted from the bill on the House floor by a floor amendment. Proponents of an increase in the national standards contend that milk fortified with nonfat solids is a better tasting, more nutritious product that would likely increase consumer demand for fluid milk. The opposition, led by dairy processors and some consumer groups, counters that fortifying milk with nonfat solids would be so costly that the higher consumer costs would more than offset any positive effects of the higher standards. (For more information on nonfat solids standards, see CRS Report 96-120, *Nonfat Solids Standards for Milk: Farm Bill Proposals*.)

Processor-Funded Promotion Program

Section 146 of the 1996 farm bill extends the processor-funded fluid milk promotion program until December 31, 2002. The Fluid Milk Promotion Act of 1990 (Title XIX, Subtitle H of the 1990 farm bill) originally authorized a fluid milk promotion program to be funded by a 20-cent per cwt. assessment on all fluid milk marketed by processors, through December 31, 1996. The fluid milk order became operational in December 1993, following a referendum among dairy processors to determine if a majority favored implementation of the order. The *processor*-funded promotion program is separate from the *producer*-funded dairy promotion program, which assesses dairy farmers 15 cents per hundredweight (cwt.) for all milk marketed for generic promotion, advertising, research, and related activities aimed at expanding the consumption of milk and dairy products. Fluid processors sought the creation of a separate program for fluid milk promotion in an attempt to reverse a long-term decline in the consumption of fluid milk, and in milk's share of the U.S. beverage market.

Dairy Export Incentive Program

The Dairy Export Incentive Program (DEIP) pays cash bonuses to U.S. dairy exporters, allowing them to sell certain dairy products in targeted countries at prices below U.S. market prices. The program is designed to help make possible the sales of U.S. dairy products that otherwise would not have been made due to subsidized prices offered by competitor countries, especially the European Community. By facilitating export sales, the program is expected to provide benefits to dairy farmers through increased commercial demand for dairy products and the resulting improvement in market prices. DEIP is administered by USDA's Foreign Agricultural Service (FAS) and is financed through the CCC. Program outlays, which were approximately \$64 million in FY1995, are included in the total outlays of the dairy price support program. Legislation implementing the Uruguay Round agreement extended the program through 2001. However, the agreement requires significant cutbacks in agricultural export subsidy programs over the six-year implementation period.

Section 148 of the enacted 1996 farm bill extends DEIP through 2002 and authorizes full funding for the program to the maximum allowable level under the Uruguay Round agreement.

Other Dairy Trade Provisions

- Section 149 requires the Secretary of Agriculture to provide advice and assistance to the U.S. dairy industry as necessary, to allow the industry to establish one or more export trading companies, to facilitate the export of dairy products. The provision requires the extent of such government assistance to be consistent with U.S. obligations under the Uruguay Round agreement.
- If the U.S. dairy industry has not established an export trading company by June 30, 1997, or if the volume of U.S. dairy exports in the year ended June 30, 1998 is not 1.5 billion pounds (milk equivalent) greater than the previous 12-month period, section 150 requires the Secretary to indicate which interested private entity or entities is best suited to perform this function. This section expires on September 30, 2000.

- Section 151 requires the Secretary of Agriculture to conduct a study to determine what effects the increase in cheese imports into the U.S. required by the Uruguay Round agreement will have on U.S. milk prices, dairy producer income, and federal dairy program costs. The Secretary must report his findings to the House and Senate Agriculture Committees by June 30, 1997.
- Section 152 amends the statutory authority for the producer-funded dairy promotion program to state that the dairy promotion board may expend funds to develop international markets for the consumption of U.S. dairy products.

For information on the implementation of the dairy provisions of the 1996 farm bill, see CRS Issue Brief IB95103. For a legislative history of the 1996 farm bill dairy provisions, see CRS Report 96-419, *Dairy and the 1996 Farm Bill: A Legislative History*.

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