Program on Dairy Markets and Policy Information Letter

Significant Changes to the Milk Income Loss Contract Program Under Current Legislation

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Crop growers have had and will continue to have access to crop insurance (assuming they took some out), but the livestock sectors, including dairy, are suffering both direct and indirect effects of the drought. Some, more likely many, ranchers and farmers are experiencing hot, dry weather effects on growth, reproduction, and milk production directly, do not have access to sufficient water for their animals, and suffer the obvious but indirect cost affects of poor homegrown feeds and expensive purchased feeds.

The ongoing drought situation has not escaped the attention of Members of Congress, but clearly they have had a hard time knowing if or what they ought to do about it. For some, it adds to the urgency of passing new agricultural legislation, completing the Farm Bill process. For the House leadership, it failed to push them to an entire new farm bill but it did inspire the House to pass special livestock disaster assistance legislation - Agricultural Disaster Assistance Act of 2012 (H.R. 6233). The Senate leadership was unimpressed with this move and argues that the House should pass the Farm Bill it already has received from the Senate, or something like it, so that a new Farm Bill could be completed. It would contain adequate or better disaster assistance for ranchers and other livestock operations

The House bill dealt with restoring certain benefits that have already expired or creating something new for the livestock industry that would address their current hurt. Those provisions would not be of much use to the vast majority of dairy farmers. On the other hand, dairy farmers have had MILC, and MILC has been kicking in big time this summer, BUT MILC under the 2008 legislation dramatically changed on 1 September and effectively ended the program. For those savvy about the usual fiscal year arithmetic, note that the change in

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* *This information letter updates an August paper that was circulated via e-mail on a more limited basis.*

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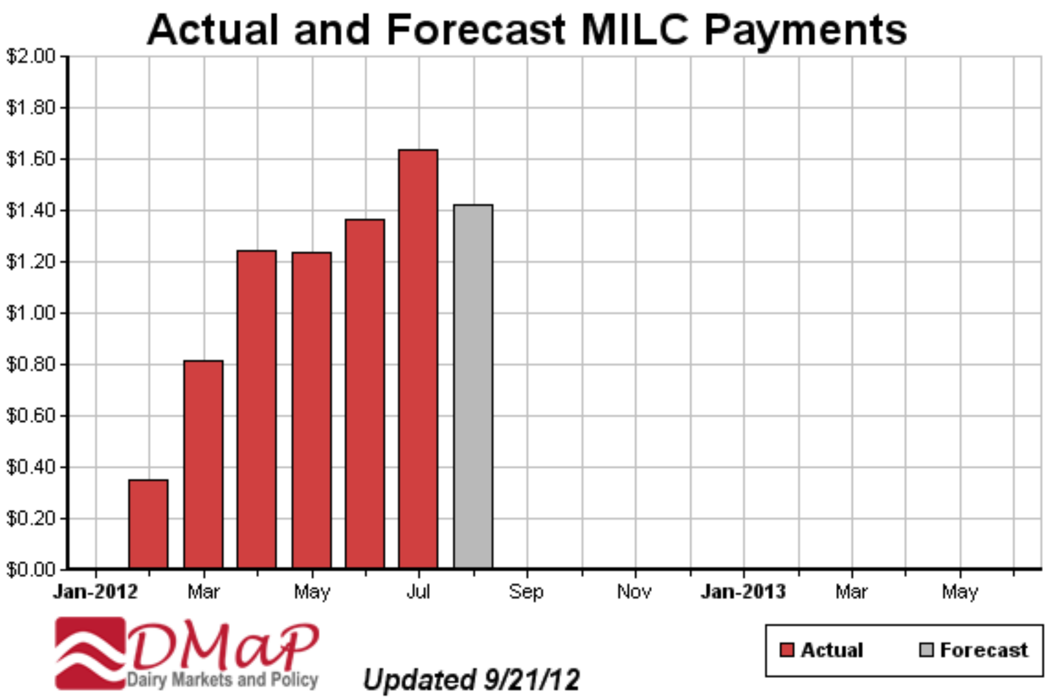
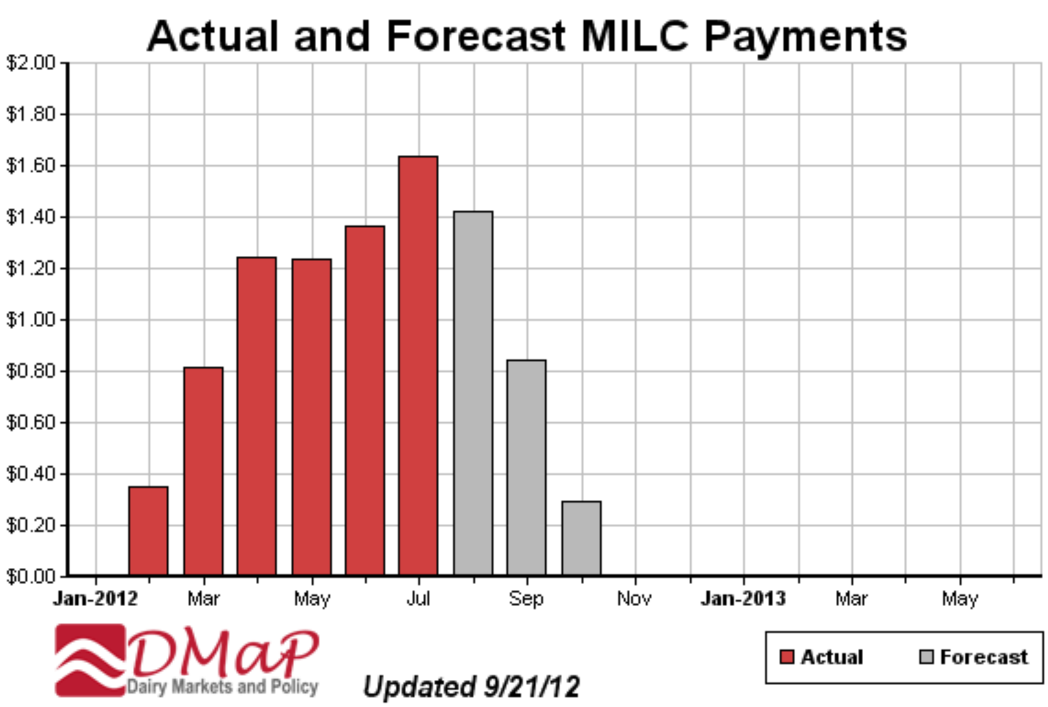
MILC took place on the first day of September, not the last day of September. The effect of these changes meant that MILC payments went from a significant something through August milk marketing to nothing for milk produced after August.

The tables below show actual and projected MILC payments under the current law (with the 1 September changes) and with the current provisions (now) extended beyond August. The red bars are actual payments announced by USDA. The grey bars are projected payments based on CME futures prices for milk, corn and soybeans. Both graphs have the same grey bars for August. The top graph has nothing after that. This means that there would be zero MILC payments if the 2008 provisions stay in place. The second graph shows a very large payment in September and payments ebbing than returning in 2013. The changes in payments after September is mostly a reflection of the fact that the CME futures prices showing milk increasing $2.08 per cwt from July to September. Under the current CME scenario, increases in milk prices begin to sufficiently offset high feed prices; hence, the MILC payments stop. However they resume when the futures price shows milk falling while corn remains high.

Of course, these projections change with every movement on the CME. Anything can happen, but some combination of milk prices booming and feed prices busting are among the more unlikely scenarios. The implications of the change in MILC rules under the 2008 are clear and large.



The actual and forecast MILC payments under the provisions of the current Farm Bill are shown above. In September, the Ration Value is scheduled to increase from $7.35 to $9.50 and the percent payout is scheduled to reduce from 45% to 34%. The combined effects are shown in the chart below.



The four specific, significant changes to MILC at the end of the 2008 Farm Bill are as follows.

1. The benchmark ration cost jumps from $7.35 to $9.50. This means that on 1 September there is no adjustment for increases in feed costs unless the national ration cost exceeds $9.50 AND how much this adjusts the milk trigger price (the Boston Class I price of $16.94) is based on the distance from $9.50, not the distance from $7.35. This is huge.
2. The payment rate drops from 45% of the difference between the actual Boston Class I and the feed adjusted $16.94 to 34%. This is a big impact also.
3. The 2.985 million pound per farm per year payment cap is dropped to 2.4 million pounds. This is important too but the least of the three.
4. No payments are authorized after September, regardless of which price calculations apply

Note that the latter means that the formula after August is only the beginning of the problem for dairy farmers who have depended on MILC payments.

So, what is possible from a policy perspective going forward?

1. A new farm bill is passed before 1 October. No one would bet on this now, but even if it did happen, this doesn't change the fact that MILC goes to zero in September anyway. Furthermore, it will take a while to gin up the new margin insurance program. Payments might be retroactive and/or MILC could be extended until the margin program is implemented. Dairy friendly Representatives and Senators want to build that policy bridge, but there is no guarantee that they will be successful
2. A new farm bill is not passed on time. This scenario has become all but certain. Thus, many people have been thinking there would have to be some kind of extension of the 2008 farm bill. That's a pretty good bet but that doesn't mean that 1) the extension would be passed before 1 October or 2) that an extension would maintain the current MILC parameters. September looks bad under this scenario and what happens after that depends on how MILC is extended. Again, an extension could restore benefits retroactively, but that seems a bit less likely the more an extension is postponed.
3. No new farm bill and no extension of the 2008 farm bill in sight. This could inspire dairy state Members to write a standalone MILC bill. That would be a tough sell for several reasons, but it isn't entirely out of the question.

MILC fell off the cliff on 1 September, but it is clinging to a branch just over the precipice. Barring any new or retroactive action, the branch breaks on 1 October.