

Dairy Product Price Support Purchase Prices Could be Adjusted When Operating Costs Change
Analysis provided to Dairy Industry Advisory Committee by Farm Service Agency

During analysis on the Milk Price Support Program (MPSP) for the Office of Management and Budget in 2006, a possible guideline for setting milk price support rates was developed. This guideline was not adopted in the 2008 Farm Bill. This guideline would have led to higher Dairy Product Price Support Program (DPPSP) purchase prices and would have contributed more toward the Aggregate Measure of Support that is limited by World Trade Organization (WTO) agreements.

Dairy farmers have asserted that the farm safety net provided by the DPPSP is not as effective as it used to be. This has occurred because the support rate has been held constant over the last decade while production costs have increased significantly. Thus, as market prices fall toward the support program purchase prices, dairy farmers receive a smaller share of their production costs than they used to.

In 2000, the MPSP support rate of \$9.90 per hundredweight (cwt) of milk was equal to the median dairy farm operating costs, calculated by the Economic Research Service, USDA, which include; feed, veterinary and medicine, bedding and litter, marketing, custom services, fuel, lube, and electricity, repairs, other operating costs, and interest on operating capital. The level of support could be adjusted over time to maintain the equivalent support price relative to the median farm operating cost for milk. Minimum dairy product purchase prices are currently established in the 2008 Farm Bill. Those purchase prices, \$1.13 per pound for cheddar cheese, \$1.05 per pound for butter and \$0.80 for nonfat dry milk are equivalent to about \$9.40 per cwt for Class III and Class IV milk, respectively.

U.S. average farm operating costs for milk have varied from \$9.38 per cwt in 2000, steadily increasing to \$11.43 per cwt in 2006, then more rapid increases to \$13.16 per cwt in 2007 and \$16.10 per cwt in 2008, and a decline in 2009 to \$14.58 per cwt. Recent median operating costs have been \$14.30 per cwt in August 2009 and \$14.19 per cwt in June 2010. A \$14.19 per cwt milk price support rate would require a cheddar cheese purchase price of \$1.51 per pound, which is slightly below the latest market price (\$1.77), and butter and nonfat dry milk purchase prices of \$1.61 per pound and \$1.11 per pound, respectively, which are also below current market prices (\$2.19 and \$1.16, respectively, in 10/2010).

Adopting this guideline for establishing DPPSP purchase prices would make the program more effective as a dairy farm safety net. However, government expenditures for dairy product purchases would be expected to be higher and government dairy product stock management could become an issue, if government stocks overhang the market or displace commercial sales when released or sold. While the 2008 Farm Bill gives the Secretary the authority to increase purchase prices for cheddar cheese, butter and nonfat dry milk, any increase would have to be approved by the Office of Management and Budget since an increase has cost implications for the DPPSP and for dairy policy. Increasing the purchase prices for cheddar cheese, butter and nonfat dry milk, and thereby the minimum price for milk, would likely reduce the adjustment that producers would otherwise make in response to low milk prices and lower payments under the Milk Income Loss Contract (MILC) program. In the late 1970's and early 1980's, annual increases in the support price for milk led to chronic government surpluses of dairy products and large expenditures under the MPSP. The DPPSP's contribution to the Aggregate Measure of Support would also be expected to increase which could challenge the limits established by WTO agreements.