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Dairy Security Act Would Milk Taxpayers

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As the congressional "super committee" grapples with deficit reduction, all manner of spending is under scrutiny. A small group of farm-state lawmakers is proposing an overhaul of dairy subsidies that would supposedly reduce outlays by $131 million over 10 years. That is just a quarter of the dollars doled out annually on price controls and income supports for milk producers. In reality, much of the purported savings is illusory, and the restructuring would perpetuate producers' dependence on taxpayers.

Supporters are planning to submit the Dairy Security Act of 2011 (H.R. 3062) this week to the Joint Select Committee on Deficit Reduction. A similar proposal, part of a broader rewrite of agriculture programs, is already pending before the panel. And while some of the proposed reforms are wise and most welcome—including termination of two costly and unnecessary subsidy programs—the creation of two new ones to take their place undercuts the reform effort.

New Deal, Bad Deal. Existing dairy subsidies and other protectionist policies date back some 70 years, the product of New Deal market manipulations to control agricultural prices. Congress has tinkered with various milk programs over the decades, but the U.S. Department of Agriculture (USDA) continues to "manage" supplies through a jumble of price controls and income supports for farmers.

In the past, advocates cited the perishable nature of milk as justification for government intervention in the dairy industry. But technological advances have revolutionized milk production, making such interventions obsolete—if they were ever needed to begin with.

Dramatic price fluctuations and the consolidation of dairy operations expose the failure of existing milk policies to stabilize prices or sustain family farms as intended. In the past decade, for example, U.S. milk prices have fluctuated between $12.18 per hundredweight (cwt) to $19.21 per cwt.[1] At the same time, the number of milk cow operations has declined 33 percent, from 97,460 in 2001 to 65,000 in 2009. Nonetheless, milk production has increased 15 percent in the same period, in large part owing to a greater number of large operations.[2]

Milk's Double Whammy. What has remained unchanged through seven decades of dairy policy is the price distortions that result from the government's interference. By limiting supplies to maintain higher prices, consumers pay hundreds of millions of dollars more for milk, butter, cheese, and a variety of other dairy products.[3] Thus, Americans are taking a double hit on dairy: Tax revenues are used to subsidize producers, and production limits raise the cost of products.

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Producers of dozens of other commodities manage to earn a living without continuous cash infusions from taxpayers. Given the advances in the milk industry—including remarkable improvements in efficiency and productivity[4]—there is little reason to persist with corporate welfare for dairy cows.

Wise and Welcome Program Cuts. On the upside, the Dairy Security Act would end the Dairy Product Price Support Program, under which the USDA guarantees the purchase of dairy products to prevent a drop in prices. In practice, the program was dysfunctional; the guarantee of a price floor prompted investment in production facilities for the very products that the government was buying to reduce supply.

The bill would also retire the Milk Income Loss Contract Program, which provides subsidies to producers when milk prices fall below statutory limits. Nearly $1 billion was disbursed under the program between October 2008 and September 2010.[5]

Also targeted for elimination is the Dairy Export Incentive Program, which was established to pay cash "bonuses" to dairy exporters who could not otherwise compete overseas because of the inflated cost of U.S. dairy products. However, the program was little used in recent years because of restrictions related to the World Trade Organization.

It is unfortunate that the legislation does not kill outright the Federal Milk Marketing Orders. As currently structured, the orders set minimum prices for milk that food processors must pay handlers. Aside from keeping milk prices artificially high, such price guarantees stifle efficiency gains among milk producers and discourage dairy product innovation.

Proposed Reforms Fall Short. The legislation calls for creation of a "Dairy Producer Margin Protection Program." Here, *margin* refers to the difference between the price at which producers sell their milk and the cost of the feed necessary for them to produce it. Every farmer who enrolls in the program would receive government payouts—compliments of taxpayers—whenever their margin is less than $4.00 per cwt of milk for two consecutive months.

The margin protection program is intended to replace an existing subsidy that is triggered when the wholesale price of milk falls below $16.94 per cwt. Payments under the existing program are capped, but there is no cap under the proposed margin protection program. Consequently, taxpayers would be saddled with the costs of yet another bottomless entitlement.

The margin protection program would be voluntary, but anyone who opts in would be required to participate in a "Dairy Market Stabilization Program." When a specified milk–feed margin threshold is breached, a participating farmer who is producing more than his allotted share of milk[6] would have a portion of his proceeds withheld. The idea is to incent farmers to curtail production (or reduce efficiency) when milk prices are low and production

1. U.S. Department of Agriculture, *Overview of the United States Dairy Industry*, September 22, 2010, at *http://usda.mannlib.cornell.edu/usda/current/USDairyIndus/USDairyIndus-09-22-2010.pdf* (October 29, 2011).
2. *Ibid.*
3. A survey by the General Accountability Office found that U.S. prices for butter averaged twice the world price, cheese prices were about 50 percent higher, and nonfat dry milk prices were about 30 percent higher. See Government Accountability Office, *Dairy Industry: Information on Milk Prices, Factors Affecting Prices, and Dairy Policy Options*, GAO-05-50, December 29, 2004, cited in Chris Edwards, "Milk Madness," Cato Institute, July 2007, at *http://www.cato.org/pubs/tbb/tbb_0707_47.pdf* (October 29, 2011).
4. The annual average rate of milk production per cow for operations with more than 500 head increased 8 percent between 2001 and 2009. Milk per cow for operations with less than 500 head increased 10 percent. See USDA, *Overview of the United States Dairy Industry.*
5. Report of the Dairy Industry Advisory Committee, March 2011.
6. Each participating producer would have a milk production base—the highest annual milk production from the three yearst prior to implementation. This milk base would be fixed for the five-year duration of the basic margin protection program.

costs are high in order to tighten supply (and thus raise prices). The cash withheld would be forwarded to a dairy board to purchase milk and other dairy products with the intent of further reducing retail supply.

The entire edifice rests on high participation rates among milk producers. However, if enough producers take a pass on the margin protections and continue milk production—or increase it—the effects of both the market stabilization program and margin protections would be neutralized. That would necessitate protracted government payments to the farmers enrolled in the program.

Replacing the existing income and price supports with new ones would supposedly result in a budget savings of $131 million over 10 years, according to the Congressional Budget Office.[7] But that estimate relies on optimistic rates of program participation and fails to account for the added expense of USDA purchases of commodities for school breakfast and lunch programs and other nutrition assistance. Nor does it reflect the higher retail costs to consumers.

None of which is to say that the cost of feed does not present a challenge to milk producers. The farm price of corn, a mainstay of feed, peaked at $5.47 per bushel in July 2008, up nearly $2 per bushel from a year earlier.[8] But instead of subsidizing milk producers for the higher cost of feed, Congress would do a great deal better by eliminating the biofuel mandates (such as those for ethanol) that are a major cause in the run-up of corn prices.[9]

Market-Driven Remedies Needed. As outlined above, the Dairy Security Act falls well short of the fundamental reforms necessary to establish rationality in milk pricing and to save Americans from the onerous costs of subsidies and artificially inflated prices of dairy products.

Lawmakers would do well to adopt market-driven remedies to income unpredictability such as private farmer savings accounts.[10] For example, farmers could be allowed to make contributions to a tax-deferred account during "years of plenty" and then draw from these accounts when their annual income fell below a specified threshold. In this way, they could even out their incomes without costly and complicated bureaucratic farm programs. While contributions would be deducted from taxable income, taxes would be paid on withdrawals, just like IRAs. An improved crop insurance system (with no new net costs) would assist when major disasters deplete most farmers' accounts.

Market-based reforms are being implemented elsewhere, and there is no reason the United States should not finally abandon the New Deal paradigm and instead adopt a 21st-century agriculture policy.

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7. Dennis Shields, "Dairy Market and Policy Issues," Congressional Research Service *Report for Congress*, R40205, October 26, 2009, at *http://www.nationalaglawcenter.org/assets/crs/R40205.pdf* (October 31, 2011).
8. *Ibid.*
9. USDA, *Overview of the United States Dairy Industry.*
10. See Brian M. Riedl, "Farm Subsidies Ripe for Reform," Heritage Foundation *Commentary*, March 29, 2011, at *http://www.heritage.org/Research/Commentary/2011/03/Farm-Subsidies-Ripe-for-Reform.*