The Regional Implications of the Current Senate Farm Bill Dairy Provisions

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The majority staff of the House agriculture committee asked FAPRI to examine the regional differences that exist in the current dairy provisions of the Senate's farm bill package. This report will highlight three areas that need to be addressed when comparing the different regions and expected outcomes under the new dairy provisions. The first issue relates to the total amount of money that is included for each of the two direct payment programs. The second is how each of the programs will work under different market price outcomes. The last will examine the use of the 5-year moving average U.S. all milk price as the determinant for direct payment calculation for states outside of the Northeast region.

Before detailed examination of expected program differences between the Northeast and the remainder of the country, it is important to first review the underlying policy. The Senate's proposed dairy provision examined here provides one direct payment scheme for the Northeast states and another for the rest of the country. States included in the Northeast region are: Connecticut, Delaware, Maine, Maryland, Massachusetts, New Hampshire, New Jersey, New York, Pennsylvania, Rhode Island, Vermont, and West Virginia. Direct payments in the Northeast are triggered off of the difference between $16.94 per cwt and the Boston minimum class I price. Payments are to be made on a monthly basis but only on class I milk (the Northeast Federal Order has roughly 45% class I utilization). Essentially, the effective payment rate a producer would receive on all milk produced would equate to 0.45 times the difference between $16.94 and the Boston minimum class I price.

The remainder of the country has a direct payment program triggered off the difference between the 5-year moving average U.S. all milk price and the U.S. all milk price for the quarter in question. This difference is multiplied by 0.4 to arrive at a payment rate to producers. Both programs cap eligible production to the first 8 million pounds of milk produced in a year over the 1999 to 2001 period. For FY02 to FY05, Northeast program outlays are capped at $500 million while program outlays for the remainder of the country are capped at $1,500 million.

While the Northeast program is eligible to spend 25% of the $2,000 million total, these same Northeast states represented 17.8% of total milk production in 2000. The fact that these states could receive 25% of the total outlays for the direct payment program yet represent less than 20% of total milk produced in the U.S. highlights that the total direct payment dollars per unit of milk produced would be higher in the Northeast under this program. This assumes that the entire $2,000 million in outlays is spent.

When analyzing how these direct payment programs would work under alternative market conditions, history provides some guide. Looking first at the Northeast states, Boston class I prices for the period January 2000 to December 2001 would have produced an average direct payment of $0.57 per cwt., averaged across all milk produced (assuming 45% class I use). The highest payment of $1.34 per cwt. would have occurred in February 2000.

For the rest of the country, a 5-year moving average U.S. all milk price of $14.10 per cwt. would have generated an average direct payment of $0.40 per cwt over the January 2000 to December 2001 period. Like the Northeast, the highest payment would have occurred in February 2000, but would have come in at $0.92 per cwt.

These relative payment rates are close to those found in the FAPRI analysis of the Senate dairy provisions (for the FAPRI report see http://www.fapri.missouri.edu). On average over the 2002 to 2005 period, the FAPRI analysis shows a direct payment rate of $0.45 per cwt. for the Northeast and $0.36 for the remainder of the country. It appears that in nearly all market conditions, the Northeast program will have a higher direct payment rate than the rest of the country. Under alternative market conditions, the direct payment rates in each of the regions remain proportional to each other.

Another difference between the two programs is the base price used in each of the direct payment formulas. Under the Northeast program, the base rate is set at $16.94 per cwt. throughout the life of the program. Alternatively, the calculations for the remainder of the country are tied to the 5-year moving average of the U.S. all milk price. Under market conditions that would result in lower all milk prices relative to those observed in the 1997 to 2001 period, the rest of the country would see reductions in their base price that would in turn lower their direct payment rate. Based on FAPRI projections of milk prices, the 5-year moving average U.S. all milk price is expected to decline by $0.79 per cwt. over the 2002 to 2005 period. Understand however that this result is completely dependent on the FAPRI baseline showing all milk prices in the $13 per cwt. range over the 2002 to 2005 period. This compares to an average all milk price of $14.11 per cwt. over the 1997 to 2001 period.

All three of the issues raised above result in the Northeast direct payment program returning more money per unit of milk produced than the program for the remainder of the country. The percentage of total direct payment funds that is targeted to the Northeast region is the largest factor driving higher benefits to the Northeast. The parameters of each of the direct payment programs also tend to favor higher payments to the Northeast region regardless of market conditions. Producers in both regions of the country are expected to benefit from the direct payment programs.