MILC: Nectar for struggling dairy farms

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The market for milk has gone sour. Persistent low prices over the past year have forced increasing numbers of Ninth District dairy farms out of the industry. However, those still in business have received a helping hand from a relatively new government subsidy program.

The steady decline in the number of dairy farms in the district over the past decade mirrors a national trend. From 2002 to 2007, Minnesota and Wisconsin saw the number of dairy farms decrease about 15 percent and 11 percent, respectively. Other district states produce much less milk, but they experienced declines of a similar magnitude. Montana, where a number of cattle ranchers have taken up dairy production as a sideline, was the exception (see Chart 1).

Declining numbers of farms has been a theme in U.S. agriculture for a long time. However, between 2002 and 2007, the total number of farming operations, nationally and in most district states, rose slightly (see "Not your father's farm," *fedgazette,* May 2009). The fact that dairy farmers continued to leave the business, bucking the overall trend, speaks volumes about their plight.

The loss of dairy farms traces back to milk prices, which have been on a roller coaster in recent years, and high input costs.

Milk prices attained record highs in 2007 and remained elevated for most of 2008. But later that year, the national average price of milk fell about 40 percent over a six-month period before creeping back up (see Chart 2). The National Milk Producers Federation attributes this decline largely to a sharp drop in international demand during the recession that left the domestic market awash in milk.

Unfortunately for dairy farmers, the recent and extended period of high milk prices was not the cash cow it might seem because of an input-cost squeeze. The price of feed like alfalfa and corn skyrocketed in 2008, negating much of the profit potential of high milk prices. Then milk prices came down faster than input costs. "It has put a big cash squeeze on the producer," said Tom Ludy, founder of Lake Country Dairy in Turtle Lake, Wis.

Some dairy producers have managed to keep afloat in this turbulent market by taking advantage of government subsidy programs. The newest of these is the Milk Income Loss Contract, or MILC. When Congress added MILC to the stable of established dairy support programs in 2002, it was meant as a temporary measure to tide dairy operations over through tough times. But the program was reauthorized in 2005 and later included in the 2008 farm bill.

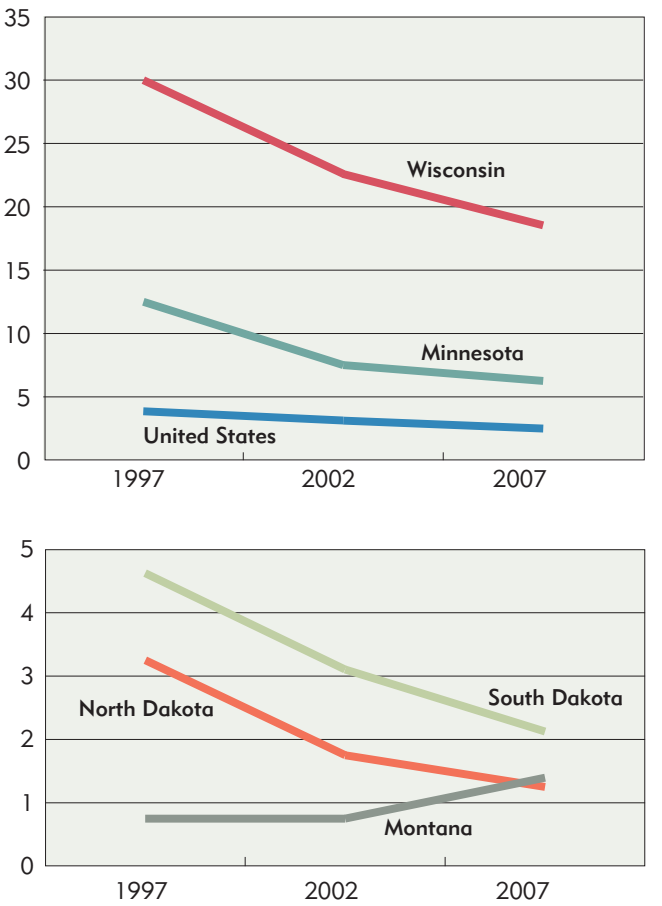
The program was envisioned as a "next-generation" farm policy that partially compensates farmers for low prices instead of manipulating the market through government purchases of dairy products. MILC goes into effect automatically when the market price of milk falls below a certain target—currently $16.94 per hundredweight (cwt.). Producers are paid 45 percent of the difference between the market price and the target for each hundred pounds of milk they produce, up to a production cap intended to ensure the payments benefit smaller producers. (For more background on MILC and other dairy programs, see "Got MILC?" *fedgazette,* November 2004.)

The 2008 farm bill modified MILC, increasing the production cap from 2.4 million pounds a year to almost 3 million. More important, given the current input-cost crunch, compensation rates were changed to reflect not only milk prices but also the cost of production inputs. If the price of the amount of alfalfa, soybeans and corn required to produce a hundredweight of milk

CHART 1

Dairy farms decreased relative to total farms nationally and in most district states

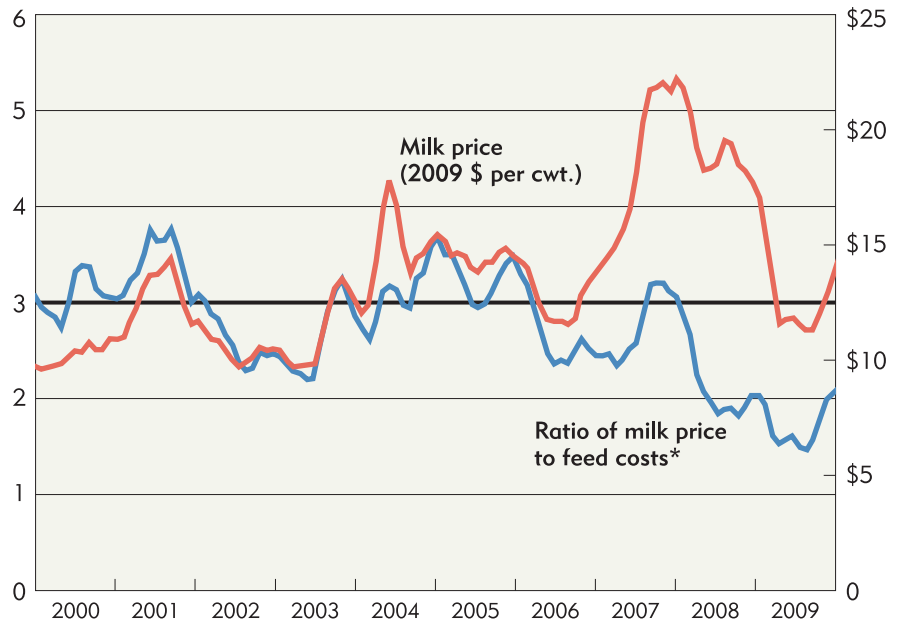
Operations with milk sales as a percent of total farm operations



Source: USDA, Census of Agriculture

CHART 2

Milk prices have been volatile and haven't kept up with feed input costs



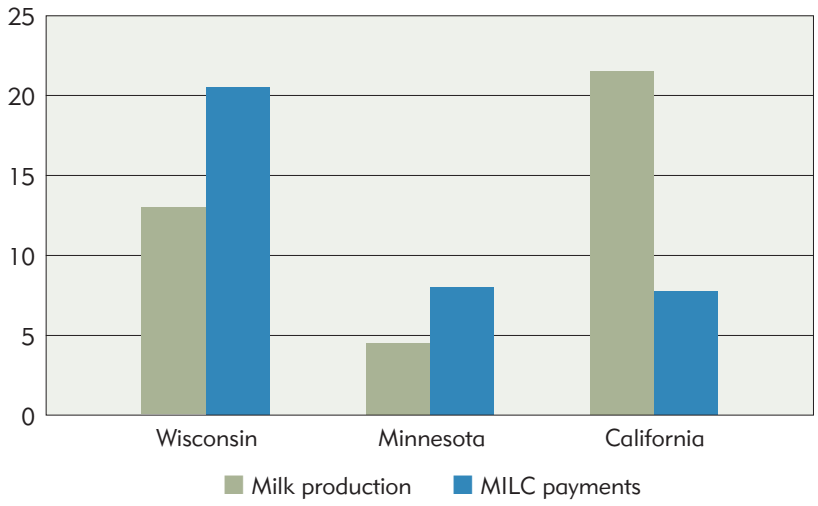
* The milk feed-price index is calculated by the USDA as the ratio of the milk price to feed costs required to produce it. A value of 3 is the estimated break-even point.

Source: National Agricultural Statistics Service, USDA

CHART 4

District states receive an outsized share of MILC payments

Percentage of national milk production and MILC payments, 2002–08

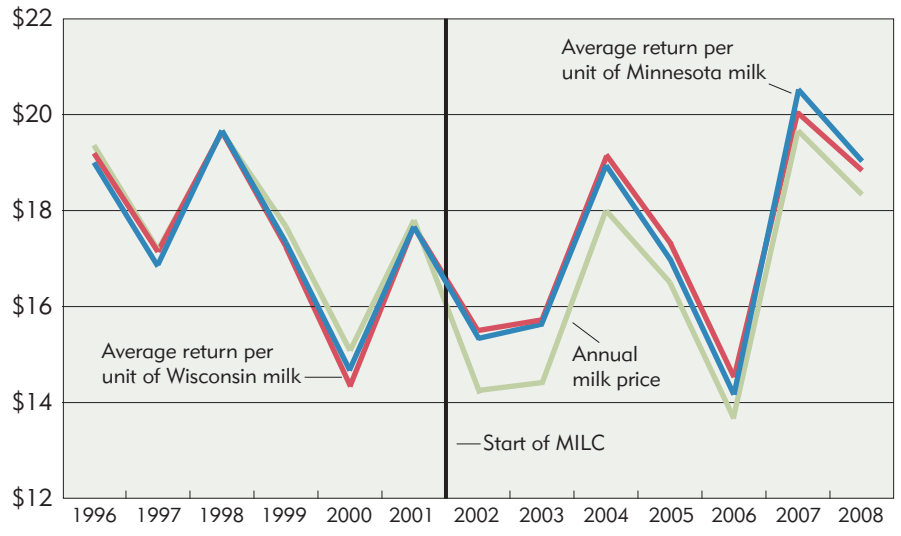


Sources: National Agricultural Statistical Service, USDA; Farm Service Agency, USDA

CHART 5

MILC payments cushion lower milk prices

2008 dollars per cwt.

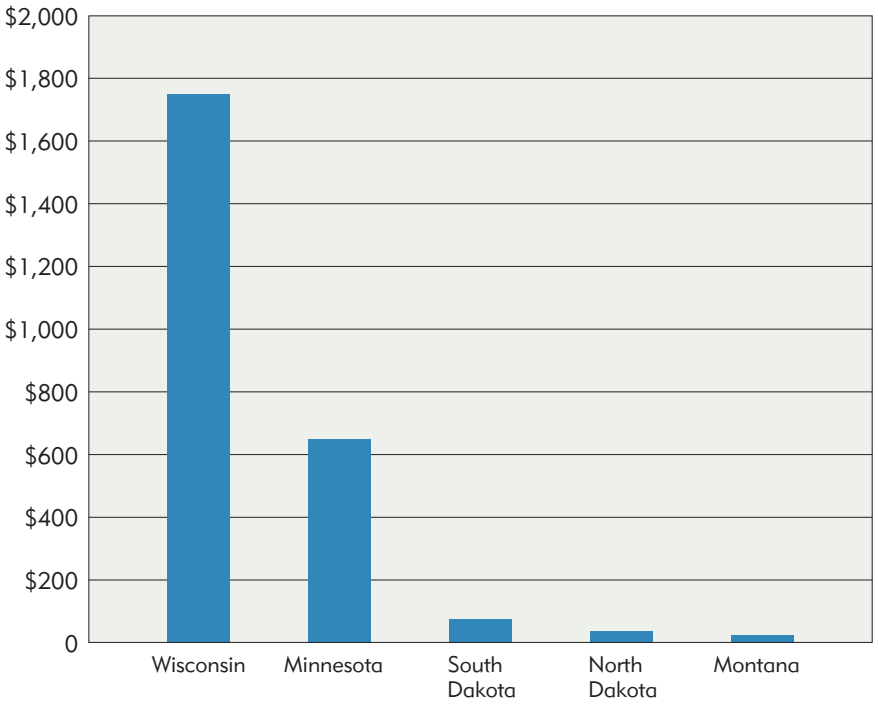


Source: Economics, Statistics and Market Information System, USDA

CHART 3

MILC payments to district states, 2009

Millions of dollars



Source: Farm Service Agency, USDA

exceeds a target of $7.35, payments to dairy producers increase by 45 percent of the difference.

MILC payments are only triggered when the price of milk drops below its target. But due to high input costs, recent market conditions have resulted in higher payments for district dairy producers. Chart 3 shows dairy payments made to district farmers in fiscal 2009, from February, when payments were triggered, through September. (Payments also went out in October and November, but those data were not available.) Last December, milk prices rose above the target, halting payments.

Wisconsin gets a giant share of MILC payments, partly because it's a major milk producer. But Wisconsin also receives more than double the payments disbursed to California, despite the fact that it ranks second behind California in national milk production. This disparity is due to the concentration of small milk producers in Wisconsin (and in the rest of the district).

In 2007, more than half of producers in district states had fewer than 200 milk cows; the national figure was 28 percent. Dairy farms tend to be larger in western states—in California only 1 percent of dairy producers had fewer than 200 cows. Because a dairy farm needs on average only 165 cows to butt up against MILC's annual production cap, the program doesn't cover much of the output in states dominated by large operations. This has been true throughout the life of the MILC program, as illustrated in Chart 4.

Comparing MILC payments for 2009 with previous years puts in perspective the recent suffering of dairy farmers. From 2002 through 2008, Wisconsin received about $73 million annually ($511 million total) in MILC payments. In fiscal 2009, it received $175 million. This payment ratio was similar nationally and in other district states, and far exceeds the expectations of policymakers when the program was launched.

Assessing the impact of MILC payments on dairy farm income is difficult, but a look at average returns of dairy operations suggests that it's significant. Chart 5 shows that returns from dairy operations move closely with milk prices. However, average returns for both Minnesota and Wisconsin dairy farmers have been higher compared with milk prices since MILC went into effect in 2002. This is particularly the case when milk prices are low.

Among other things, the MILC program acts as a safety net for smaller producers in the district. While many dairy farmers choose to get out of the business even in prosperous times, the program has shielded them to some extent from the impact of low dairy prices. For better or worse, it's likely that without it, even larger numbers of dairy producers in the district would have shut down their operations. **f**