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MCT COMPASS

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Hooked on subsidies

The 2002 Farm Bill will make its mark in history books as the most expensive ag program ever. The bill is fiscally lucrative and politically motivated, simply because control of Congress is up for grabs in this fall's elections.

For the dairy industry the Farm Bill means continuation of a cheap feed-grain policy and provides a target price deficiency payment to milk producers. Under the new National Dairy Market Loss Payments (NDMLP) scheme, dairy producers nationwide will receive a check each month for 45% of the difference when the Class I Mover falls below $13.69. For example, the June 2002 Class I Mover is $11.03; the June payment is 45% of the difference between $13.69 and $11.03, or $1.20/cwt. Subsidies will be doled out on 2.4 million lbs. of milk marketed during the fiscal year, the equivalent of about 130 cows.

USDA now has 60 days to write the guidelines for how the NDMLP will be implemented. Once again, Congress didn't do the department any favors by passing vague legislation.

One of USDA's challenges will be to determine how the 2.4-million-lb. volume cap will be defined. Senator Leahy supports a liberal interpretation of the production cap, insisting that each owner of a farm have separate limits. In other words, if a farm is jointly owned by a husband, wife and two children, that farm would qualify for four checks, giving them subsidies on 9.6 million lbs. of annual milk production.

Beyond that, the department also must devise a fair and workable way to split up the volume cap. The law says payments are to be made on monthly production, but it's unspecified if that means the *first* 2.4 million lbs., or some other 2.4 million lbs. produced during the year.

The way this is defined can make a big difference. For example, a large producer could go through his production cap in the first month; if the Class I Mover is close to, but still below, $13.69 that month, the subsidy will be smaller than the subsidy paid during months when the price is lower.

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KEN'S CORNER

by Ken Meyers
President
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Don't get me wrong; I believe farmers are some of the hardest-working people on the planet, and they deserve to be compensated for the extraordinary business risk they face every day. But my understanding is that most producers prefer to get their paychecks from the marketplace rather than as government welfare payments. Unfortunately, it appears market orientation in agriculture is now a thing of the distant past, as an increasing proportion of farm income comes in the form of a government check.

I know USDA has its hands full trying to figure out these market loss payments, but the way they've handled the butter-powder tilt over the last six months is just terrible. They simply have to do a better job of communicating their intentions with the industry. They been stringing us along since last fall – will they? won't they? how much? – and in the meantime, it's added yet another layer of unnecessary distortion to doing business in the dairy industry. If they're going to tilt, then say so. If not, say that too. Either way, we need some sort of resolution in order to implement effective business planning. ❑

Prices at 2002 lows?

Prices are in the doldrums, but we think we're close to the seasonal low. As summer kicks in and production drops seasonally, cheese and butter markets should tighten. So far in 2002, demand has been lackluster. Cheese stocks have climbed above year-ago levels and butter inventories are expanding at a record pace.

We look for the block price to peak in the mid-$1.40s this fall, while butter climbs into the mid- to upper-$1.20s. Class III prices will top out near $13.00, while Class IVs will struggle to reach $11.00. ❑

MCT Forecast

	Block*	Barrel*	Class III	Butter*	Class IV
MAY	1.2045	1.1735	10.84	1.0750	10.56
JUN	1.2325	1.2075	10.53	1.1000	10.66
JUL	1.3125	1.2875	11.21	1.1450	10.81
AUG	1.3725	1.3475	11.96	1.2000	10.95
SEP	1.4150	1.3900	12.40	1.2500	11.04
OCT	1.4450	1.4200	13.11	1.2800	11.13

* Block, barrel and butter are monthly averages of CME prices.

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(Or vice versa: if the subsidy is very large the first month and smaller in subsequent months, large producers will get more than small producers.) Just to complicate matters further, in years when the Class I Mover falls short in only a few months out of the year, as it did in 2001, large producers could get significantly larger checks than small producers because large producers will reach the 2.4 million lb. limit and small producers may not.

What's the impact?

The impact of this legislation depends primarily on how it's implemented. If they define "dairy operation" as one-farm-one-check, USDA's largess will be more limited.

According to USDA, approximately 81,000 of the nation's 97,560 dairy farms have less than 130 cows and this group accounts for about 30% of the U.S. milk production. If the other 16,560 farms are limited to a single check, the law could deliver subsidies on as much as 55% of U.S. milk production.

But even this scenario could provide a significant boost in total U.S. output. Smaller producers – those with 130 cows or less – on average have herds that produce 13% less milk per cow than the national average. If this group of producers invests the additional income on improved feeding practices or bST use to the extent that they are able to boost production-per-cow by just 5%, it will result in a 1.5% gain in U.S. milk production. That's on top of the historical 1.2% gain the industry has enjoyed over time. And that's not even considering the likelihood of those producers using the money to add cows.

Of course, several issues hanging over the industry could temper the industry's supply response. Environmental restrictions and heifer availability will make widespread expansion an uphill battle. But it as illustrated above, it won't take much to switch into a structural surplus mode. The dairy markets have been known to turn on 1-2% swings in supply or demand.

Estimates vary on the total cost of the program, but just to put some numbers on the table, if the subsidy for the year was 90¢/cwt., and that covered 55% of U.S. milk production, that would be a handout of $825 million. That's significantly higher than the $200 million Congress threw at the dairy industry in 1999, or the $667 million it coughed up in disaster payments in 2000.

Who's paying for Congress' generosity? U.S. taxpayers. The total cost of the Farm Bill, allocated at $190 billion over 10 years, amounts to about $1,810 per U.S. household over the next decade. ❑

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