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Before the
Subcommittee on Livestock, Dairy, and Poultry
House Agriculture Committee
September 8, 2011

Mr. Chairman, Ranking Member, and members of the Subcommittee, thank you for the opportunity to discuss the dairy provisions associated with the Food, Conservation, and Energy Act of 2008 (2008 Farm Bill). I will be covering not only the programs associated with the Farm Service Agency (FSA), but also those associated with the Foreign Agricultural Service (FAS) and the Risk Management Agency (RMA). The programs of these agencies provide the backbone of the farm safety net for dairy producers. This hearing provides an opportunity to reflect on the performance of these programs under the 2008 Farm Bill, while thinking ahead to the upcoming Farm Bill debate.

The dairy market situation has been extremely volatile in recent years, which has greatly affected FSA programs, in particular. I will start my discussion with those programs, intertwining information on the dairy market situation to highlight our response to the very weak economic climate faced by dairy producers in 2009.

Farm Service Agency Programs and the Dairy Crisis

Several events converged in early 2009 that caused a dramatic and rapid decline in dairy prices, which averaged $12.93 per hundredweight (cwt.) for the calendar year, the lowest level since 2003. The global economic recession, the melamine scare in China, and increases in the value of the dollar lowered the demand for U.S. dairy products in world markets. In addition, more normal weather returned to the grass-fed dairy industry in New Zealand and Australia, which had been plagued by drought in the preceding years. And, at home, the economic crisis weakened the demand for dairy products.

Meanwhile, feed costs remained relatively high in 2009, causing the ratio between milk and feed prices to fall to its lowest level in more than 25 years. Financial pressure led producers to cull additional dairy cows and reduce milk production. The number of milk cows dropped from 9.31 million head in January 2009 to 9.08 million head in December 2009. In 2009, milk production declined by 0.3 percent, the first year-over-year decline since 2001.

Since April 2009, FSA has paid dairy producers more than $900 million under the Milk Income Loss Contract (MILC) program, which makes payments when market prices are low relative to a level fixed in statute. The 2008 Farm Bill kept the same basic counter-cyclical price structure for the MILC program as in the 2002 Farm Bill, but also included a “feed cost adjuster,” which increases the size of the payment depending on ration costs.

Most of these MILC payments occurred in calendar year 2009, although a payment of about $15 million was made for April production in early June, 2010. Since enactment of the 2008 Farm Bill, MILC payments have been made during 11 months; the feed cost adjuster had an impact on the payment in 5 of those months.

The dairy crisis also affected producers' ability to receive financing from commercial sources. In March 2009, FSA issued guidance on assisting dairy producers with their credit needs. This notice announced that FSA Farm Loan Programs (FLP) was authorizing the release of milk sales proceeds for essential family living and farm operating expenses and notified FLP borrowers of servicing options that could be considered by FSA on a case-by-case basis, including extending repayment terms for annual operating loans for dairy farmers, rescheduling, consolidation, reamortization, and deferral for 1 to 5 years. We also contacted guaranteed lenders to discuss FSA policies for dairy loans and remind them of loan servicing options available under the Guaranteed Loan Program that could be considered for certain producers.

USDA also expedited emergency non-Farm Bill aid to producers during the dairy crisis. The fiscal year 2010 Agriculture Appropriations Act authorized $290 million in additional direct payments to dairy producers, as well as $60 million for the purchase of cheese and other products. The $290 million was paid in near-record time—with payments beginning within 60 days of legislative passage. Under the Dairy Economic Loss Assistance Program, eligible farmers received a one-time direct payment based on the amount of milk both produced and commercially marketed by their operations during the months of February through July 2009. A 100-cow dairy farm received payments of roughly $6,000; a 200-cow dairy, about $12,000; and operations of 400 cows or more, roughly $19,000. (Note that payments did not increase proportionately for large operations because of the application of a 6-million pound production eligibility limitation.)

In addition, the Commodity Credit Corporation (CCC) stands ready to buy certain dairy products at support levels under the Dairy Product Price Support Program (DPPSP). By doing so, the DPPSP helps support market prices. The acquired products are largely used to provide assistance to needy families, both in the U.S. and overseas. In total since October 2008, CCC has purchased nearly 270 million pounds of nonfat dry milk (NDM) under the DPPSP at a cost of $227 million. Expenditures for purchases, handling, transportation, and storage were an additional $16 million, bringing total program expenditures to $243 million. No purchases have occurred since July 2009. Also during this time period, CCC purchased about 4.6 million pounds of butter, much of it during late 2008 and the first half of 2009. The Secretary announced in March 2009 that about 200 million pounds of NDM would be processed or bartered into value-added products, such as instantized nonfat dry milk, ultra high temperature milk, cheese, and ready-to-eat milk-based soups for the National School Lunch Program and the Emergency Food Assistance Program. USDA also temporarily increased DPPSP purchase prices for cheddar blocks, cheddar barrels, and NDM during August-October 2009.

With the mid-point of the all-milk price forecast to average a record of $20.40 per cwt. in calendar year 2011, no MILC payments are expected during the remainder of the year, nor are purchases under the DPPSP expected. While high feed costs are putting financial pressure on dairy producers, milk prices are at high enough levels that MILC payments will not be triggered in the foreseeable future. Indeed, no payments have been made under MILC for milk produced since April 2010.

The current strong prices are in part due to strong world dairy markets, which are supporting higher U.S. exports and lower U.S. imports. Compared to the same period a year ago, March through May exports of U.S. dairy products were 36.4 percent higher for cheese, 65.7 percent higher for butter and 13.7 percent higher for nonfat dry milk.

Dairy Export Incentive Program

The Dairy Export Incentive Program (DEIP) was authorized under the Food Security Act of 1985 and most recently reauthorized in the 2008 Farm Bill. This program, administered by the Foreign Agricultural Service, provides a bonus or subsidy on a bid basis to exporters of dairy products. By providing a subsidy on exports of dairy products, Congress intended DEIP to bridge the gap between world market prices and U.S. domestic prices. Commodities eligible under DEIP are milk powder, NDM, butterfat, and various cheeses.

The authorizing legislation for DEIP provides that the subsidy may be paid in cash or in commodities held by the CCC. As CCC inventories diminished, DEIP evolved into the sole use of cash payments for the subsidy. DEIP is subject to U.S. export subsidy reduction commitments under the World Trade Organization's Uruguay Round Agreements, and is therefore capped annually by both subsidy value and quantity in accordance with those commitments. DEIP has helped to meet the needs of U.S. exporters and expand markets for U.S. dairy products when world prices are depressed due to the application of subsidies by other nations, particularly the European Union. Agricultural economists at FAS continuously monitor the world dairy situation and have the responsibility for recommending issuing allocations under DEIP as world dairy prices dictate.

Since 2002, world dairy prices have warranted issuing allocations under DEIP five times. DEIP bonuses were last awarded in fiscal year 2010 in an amount of $2.37 million, including for sales of mozzarella cheese to China and butter to Saudi Arabia.

Livestock Gross Margin—Dairy (LGM-Dairy) Program

While not contained in the Farm Bill, insurance is an important part of the safety net for dairy producers. The Agricultural Risk Protection Act of 2000 amended the Federal Crop Insurance Act (FCIA), providing authority to RMA to offer insurance for livestock products. It also provided $20 million in funding to cover administrative and operating and premium subsidy costs for pilot livestock insurance plans each fiscal year. RMA currently reinsures eight livestock products, all of which were developed and submitted by private parties through authorities contained in section 508(h) of the FCIA. There are two basic insurance models used to provide livestock insurance – Livestock Risk Protection (LRP) and Livestock Gross Margin (LGM). LRP provides protection against unexpected declines in the price of feeder cattle, fed cattle, lamb, and swine. LGM provides protection against unexpected declines in the gross margin (difference between the price received and feed costs) of the insured livestock product for cattle, dairy (milk), and swine.

The LGM-Dairy insurance product provides protection to dairy producers when the gross margin declines. LGM-Dairy uses futures prices for corn, soybean meal, and milk to determine the expected gross margin and the actual gross margin. LGM Dairy is a private sector pilot program owned and maintained by Iowa Agricultural Insurance Innovations, LLC (IAII). RMA works actively with this entity, and is aware that IAII continues to evaluate areas for potential improvement to make the product more effective and attractive for dairy farmers.

Prior to fiscal year 2011, total annual expenditures on all livestock insurance products had never exceeded $5 million. For fiscal year 2011, about $345,523 had been spent to support all livestock products through mid-December, 2010, with LGM-Dairy accounting for $66,117 of the total. In response to dairy producer concerns, the Federal Crop Insurance Corporation (FCIC) Board of Directors approved changes to LGM-Dairy, which became effective in December 2010, including a shift in the premium due date to after the end of the insurance period and the addition of graduated producer premium subsidies. These changes, along with promotional efforts led by industry groups, resulted in a dramatic and immediate increase in sales. For the December 17, 2010 sales period, LGM-Dairy sales increased by almost $1.4 million, compared to less than $70,000 during all sales periods dating back to the beginning of the fiscal year.

Subsequently, RMA revised the funding allocation for LGM-Dairy and added an additional $5 million to underwriting capacity, using funds from other livestock products that, to date, had limited sales. Because of continued strong sales of LGM-Dairy, further revisions to the funding allocation occurred, and $16 million were eventually allocated to LGM-Dairy and $4 million to the other seven livestock insurance plans. The $16 million in underwriting capacity ran out during the sales period in March 2011 and LGM Dairy sales for the remainder of fiscal year 2011 ceased at that time.

As of August 8, 2011, less than $600,000 of funding remained for the other livestock insurance products for the remainder of fiscal 2011. As funding is depleted for each insurance product, sales will cease for that product until funds become available again beginning with the 2012 fiscal year.

Dairy Industry Advisory Committee

In response to the dairy crisis, USDA announced in August 2009 that nominations would be accepted to form a Dairy Industry Advisory Committee. The Secretary of Agriculture appointed 17 representatives from the dairy industry to serve in an advisory capacity, including producers and producer organizations, processors and processor organizations, handlers, consumers, academia, retailers, and others. The Committee's charge was "to review the issues of: 1) farm milk price volatility and 2) dairy farmer profitability." USDA very much appreciates the work of this committee, which submitted its final report to the Secretary in March 2011.

This final report includes 23 wide-ranging recommendations. USDA is currently reviewing other recommendations and considering action as appropriate. We look forward to working with Congress to develop policies that provide the most efficient and cost-effective protection to the dairy sector.

Working Toward the Next Farm Bill

Mr. Chairman, as we move forward toward development of the next farm bill, it is important that we approach this new legislation with an eye toward truly making a difference in the future of the lives of millions of rural Americans, while at the same time using scare resources wisely. In the coming months, I look forward to providing answers to your questions and helping to better frame and push the debate toward the topics and issues that are most important to our constituents.

I am happy to respond to any questions. Thank you.