
Dairy Policy Brief #2: Milk Income Loss Contract Program

What is the Program?

The Milk Income Loss Contract (MILC) program was included in the Farm Security and Rural Investment Act of 2002 (2002 farm bill) and is a type of target price/deficiency payment program that makes a direct payment to dairy producers when milk prices fall below a specified trigger level. This program includes a payment limit feature that limits the amount of a producer's annual milk sales eligible for MILC payments. The 2002 farm bill authorized the MILC program through September 30, 2005. Subsequently, the MILC program has been reauthorized through August 31, 2007 under the Agricultural Reconciliation Act of 2005 (ARA2005). The USDA has labeled this extension as MILCX. The MILC program costs totaled \$2.026 billion and the March 2006 Congressional Budget Office baseline estimates the cost of MILCX at \$969 million.

What are the issues?

- **Soft price floor.** The MILC direct payment rate under the 2002 farm bill was calculated as 45 percent of the difference between \$16.94 per hundredweight and the Boston Class I Price. The extension included in ARA2005 lowered the payout to 34 percent. MILC does not create a floor on receipts, since when payments are made, the payment rate compensates only part of the actual decline in milk prices. Other dairy target price/deficiency payment approaches that have been discussed generally propose a more solid price floor at a level lower than what is set under the MILC program.
- **Production caps.** Participating producers in the MILC program are eligible to receive a direct payment on their first 2.4 million pounds of production in a fiscal year. The production cap feature of the MILC program has proven to be a very effective way to limit program payments. But targeting of benefits to small dairy producers has made this program unpopular with large dairy producers and in areas of the country dominated by large dairies. Using the 2005 average U.S. milk yield of 19,537 pounds per cow, only dairy farms with fewer than 123 dairy cows are eligible for MILC payments on all milk sold. As milk yields and dairy operation sizes grow, the percentage of annual U.S. milk production eligible for full MILC payments declines. Based on changes in the distribution of dairy operations by size, the amount of milk eligible for full MILC payments has fallen by nearly 10 percent since the program was initiated in December 2001.
- **Milk supply impact.** The MILC program tends to lengthen periods of low milk prices. That's because program payments supplement dairy income to keep some producers—especially small farmers—in business when they might otherwise have exited dairying. FAPRI estimated that, on an annual basis, the MILC program reduced Class III milk prices \$0.25 per hundredweight. Raising the production cap would further lengthen periods of low prices.
- **Future extensions.** Because the program is not authorized for the life of the 2002 farm bill, expenditures under the MILC program are not extended in current federal budget outlay estimates. This means that continuation of the MILC program in any form would likely require either more money to be budgeted for agricultural spending or for money to be taken from other agricultural commodity programs to fund MILC. One issue surrounding the MILC program arises as Congress discusses the idea of extending provisions of the 2002 farm bill until the current WTO round ends: an extension would not automatically extend the MILC program like other agricultural provisions contained in the 2002 farm bill.