
Dairy Policy Brief #3: Target Price-deficiency Payments

What is the Program?

Target price-deficiency payment programs involve the government making direct payments to dairy farmers whenever the market price (reference price) falls short of a pre-announced price level (target price). The current Milk Income Loss Contract (MILC) program is an example. For MILC, the reference price is the Class I price in Boston and the target price is \$16.94 per hundredweight. In any month the Boston Class I price is less than \$16.94, all eligible milk marketed receives a payment of 34 percent of the difference. A permanent dairy target price-deficiency payment program would likely replace the current Milk Price Support Program (MPSP). Consequently, wholesale dairy product prices would be allowed to seek market clearing levels. But if the farm milk price falls below the target price, dairy farmers would receive a direct payment to make up the difference.

What are the issues?

- **Target price.** In theory, the target price could be set at any level, but the higher the target price the higher the probability that farm milk prices will consistently fall below the target. This would make the program income enhancing rather than counter-cyclical, perhaps resulting in burdensome government costs. A target price for manufacturing milk in the \$10.00 to \$10.50 per hundredweight range would not consistently enhance dairy farmer income. At the same time, it would provide dairy farmers a higher safety net than the \$9.90 support level under the current MPSP.
- **Payment limits.** Target price-deficiency payments can be targeted to smaller dairy farmers, if that is a policy objective. This can be achieved by limiting direct payments to a maximum quantity of milk marketed by an individual producer, as is done under MILC. Alternatively, dollar-based payment limitations can be applied, as is done in crop programs. Payment limits are objectionable to larger farmers, but they can control government costs.
- **Taxpayer and manufacturer burden.** Unlike the MPSP, which floors wholesale prices for butter, cheese, and nonfat dry milk, a pure target price-deficiency payment program would allow product prices to fall as far as necessary to clear markets during periods of milk surplus. This could result in product prices well below the MPSP floors. Consumers would benefit to the extent that lower wholesale prices are reflected in retail prices. But, taxpayers would bear the cost of deficiency payments. And even though farmers are protected by deficiency payments, their cooperatives and other processors could periodically face very low returns to manufacturing and greater product price instability.
- **WTO scoring.** The MPSP is an “amber box” domestic price support program under WTO rules, and contributes about 25 percent of the U.S.’s permitted aggregate measure of support (AMS). WTO’s AMS calculation uses the difference between the \$9.90 per hundredweight support price and a world \$7.25 reference price times the quantity of milk marketed. Only actual government expenditures would be counted under a target price-deficiency payment program.
- **Dairy product innovation.** Replacing the MPSP with direct payments would result in lower market prices for milk during periods of milk surpluses. This would challenge dairy manufacturers to be more innovative in product development and marketing.