

LEGISLATIVE AUDIT DIVISION

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MEMORANDUM

TO: Legislative Audit Committee Members
FROM: Julia Connelley, Senior Management and Program Analyst
CC: Mike Honeycutt, Executive Officer, Department of Livestock
DATE: April 2024
RE: Performance Audit Follow-Up (23SP-13): *Montana's Milk Industry: An Analysis of the State-Regulated Market* (20P-03)

Introduction

The *Montana's Milk Industry: An Analysis of the State-Regulated Market* (20P-03) report was issued to the Legislative Audit Committee in October 2021. The audit included one recommendation to the Department of Livestock. In late 2023 and early 2024, we conducted follow up work to assess implementation of the report recommendations. This memorandum summarizes the results of our follow-up work.

Overview

We found the Department of Livestock's Milk Control Bureau and the Board of Milk Control has partially implemented the recommendation. They worked with the state's dairy producers to revise administrative rules related to the state's quota system. During the original audit, we found the quota system to be outdated and an incomplete administrative rule diminished the accuracy and value of the quota system. We recommended the department pursue changes to administrative rule to allow for decreases in quota, and then decrease the amount to quota to reflect industry trends. The department relied on industry and board input for how best to allow for decreases in quota and subsequently updated administrative rule, implementing the first part of our recommendation. However, additional steps to reduce quota could assist the department and board in more effectively managing milk production in the state, though this is unlikely to occur due to the state's diminishing milk industry.

Background

The Board of Milk Control (board) is administratively attached to the Department of Livestock (department), which provides staff for the board to fulfill its statutory obligations as the Milk Control Bureau. The board was established with the Montana Milk Act in 1935 to promote and encourage dairy production and marketing through various activities including administering a producer pool and quota system. The producer pool and quota system work together to ensure producers are paid guaranteed prices each month for any milk supplied to both in-state and out-of-state processing plants within a set amount. The system was intended to regulate and maintain the supply of milk in the state and discourage excess production of milk. Montana's milk industry has been declining in size and production over the last few decades, and the demand for milk products has decreased. In recent years, production has fallen to equal about 75 percent of total quota owned by producers.

Audit Follow-up Results

The following sections summarize the progress toward implementation of the report recommendations. The one recommendation, relating to updating administrative rule to allow for decreases in quota and then

decreasing it, to the department has been partially implemented. Our follow-up work included interviewing department staff, reviewing changes in administrative rule, and reviewing updated quota records.

Recommendation #1

We recommend the Department of Livestock and the Board of Milk Control:

- A. Pursue changes to administrative rule to allow for decreases in the amount of quota owned by dairy producers, and**
- B. Decrease the amount of quota to reflect current milk production and Montana dairy industry needs.**

Implementation Status – Partially Implemented

Dairy producers and the board were attentive in responding to the audit and drafted rule changes to address the recommendation. Department staff believed it best to allow the producers and board to identify what additional rule language was appropriate and applicable for producers in the state. The new rule language, adopted September 2022, includes a mechanism to decrease the amount of quota owned by producers by not reallocating forfeited quota when a producer leaves the market. Quota is now either reduced by 10 percent when transferred to a producer (ARM 32-24-504) or automatically removed rather than reassigned when forfeited quota is not claimed by another producer (ARM 32-24-505).

During audit work, the quota forfeited by an exiting producer would either have to be purchased by a remaining producer, or reallocated to all remaining producers. Producers were regularly only producing at 75 percent of total quota, without the department having the ability to decrease the amount of quota. We learned in our other states work that states outside of a Federal Milk Marketing Order, which are federally-regulated markets for dairy producers, and with their own quota systems often had the ability to increase and decrease quota as needed for the evolving market. This allowed the quota system to better reflect industry needs. As of March 2024, the department estimated the total quota owned by producers to be about 297,700,000 pounds per year. Since the audit, the implementation of the new administrative rules reduced the statewide quota by 577,500 pounds per year, which is roughly 0.16 percent of total quota.

While the board and department have taken necessary steps to include the ability to decrease quota in administrative rule and have seen a slight reduction in quota with the implementation of the new administrative rules, the rule language and subsequent reduction in quota does not yet reflect current production in the state. Reducing quota can be a complicated process because milk producers own their quota, and is sometimes used as collateral with banks. Producers may not want to sell or reduce their quota because of this. In addition, the amount of milk produced in Montana is declining. Producers may not be willing to adjust quota to reflect the current market as it will be challenging for quota to always align with a diminishing market. However, to ensure the quota system is of value and efficacy to the industry, it is important quota accurately reflect the current production. The action taken by the board and department are impactful first steps, but in order to more closely align quota with production on an ongoing basis, additional efforts to reduce quota would be needed.