Dairy Policy Options for 1985

Perspectives on Dairy Price Support Policy: Problems, Goals, and Tools

EDITOR'S NOTE: This is the second in a series of nine articles about dairy policy options for 1985. Compiled by Jack Kirkland and Blair Smith, Extension ag economists at Penn State, the articles are written by a variety of national authorities on dairy policy issues.

We are printing these articles to help you better understand and evaluate the policies and programs the dairy industry faces. The first two articles explain the current situation, while the other seven review policies and programs that may be enacted to stabilize the dairy industry.

We are also printing the series to help you take a more effective stand for the program you choose to support. The 1985 Farm Bill has the potential of being one of the most important pieces of legislation to the dairy sector since 1949. You can influence dairy policy through your representatives in Congress, your general farm organization, your milk marketing cooperative and your political party.

For further information about these articles or about dairy policy, contact your Extension agent.

BY ANDREW NOVAKOVIC
Cornell University

For the last three years policy makers and industry participants have tried to create dairy policy within a political gridlock. Fundamental questions lie at the center of the traffic jam: Do policy makers pursue individual or common goals, and which program will alleviate the problems plaguing the dairy sector?

Discussions of policy goals and the implications of their options are seldom prominent in dairy policy debates. Whether or not they address the goals explicitly or implicitly in 1985, policy makers will influence dairy policy that could determine at how and how well the dairy sector will adjust to the technological and economic changes it will undergo in the future.

Problems and Goals Prior to the 1980's

The architects of New Deal agricultural policy identified a key farm problem–low prices. Their one objective was to raise farm prices to 100 percent of parity; a goal originally sought through a form of production controls. What emerged by the late 1930s was a dairy policy that largely embraced the goals and enforced the pricing procedures that cooperatives could not maintain on their own.

Federal orders enhanced the bargaining power of farmers and enforced a more equal distribution of returns to farmers. Even so, orders were not able to raise farm prices and maintain secure markets to the satisfaction of dairy farm interests.

The next major attempt to raise farm prices occurred during World War II as part of a larger effort to stimulate food production. After the war, with the influx of young men anxious to return to the farm, it was deemed necessary to legislate a permanent program that helped to ensure adequate returns and secure markets to existing and new generations of dairy farmers. The Agricultural Act of 1949 authorized the Secretary of Agriculture to support farm prices at no less than 75 percent of parity and no more than 90 percent of parity. This defined in practice, if not in principle, the boundaries of adequate returns and reasonable prices. Anything more precise than that was left to the discretion of the Secretary.

Stable and secure markets were essentially guaranteed by the manner in which farm prices were supported. The USDA buys manufactured dairy products at wholesale prices designed to give manufacturers enough money to cover their costs and pay farmers the equivalent of the support price. In so doing the USDA not only raises prices but also guarantees a secure and essentially unlimited outlet for market surpluses. To be sure, not every farmer or processor is guaranteed an outlet for his or her product, but USDA's willingness to purchase any quantity of cheddar cheese, butter, and nonfat dry milk at a given price comes just one step short of that.

From 1949 through 1978, under the traditional purchase program, annual net removals on a milk equivalent basis averaged four percent of total milk marketings. This implies that the operational goal of the support program is to support farm prices slightly above levels that would perfectly balance commercial supply and demand, resulting in a perennial but fairly small surplus. It is evident that both price enhancement and stabilization have been important goals in the administration of the price support program, but prior to 1979, price enhancement goals were clearly tempered by some sensitivity to market conditions.

Policy goals across agriculture shifted perceptibly during the 1970s. Reliance on intervention was replaced by faith in demand-induced growth stemming largely from greater agricultural exports. Although cash grain farmers prospered during this period, dairy farmers fared poorly as feed prices increased while support prices increased slowly and reluctantly. Between 1973 and 1975, domestic production was less than commercial disappearance, import quotas were greatly expanded to make up the shortfall, and net removals averaged only one percent of production. In 1976, President Carter fulfilled a campaign pledge to increase the support price for milk. Congress followed by enacting legislation in 1977 and 1979 that required milk prices to be supported at no less than 80 percent of parity, with semi-annual adjustments. Thus, the course was set for a level of enhancement unparalleled in the 30-year history of the program.

The shift in the mid-1970s from a very free, market-oriented policy to one of enhancing farm milk prices occurred primarily for political reasons. Dairy farmers who felt they had been short-changed during the Nixon administration convinced President Carter and Congress that they deserved compensating treatment. High parity prices and cost data convinced Congress that milk prices were not keeping up with production costs. Whatever relationship these high parity prices may have had to costs, they proved to be totally inconsistent with market supply and demand. Parity had become unreliable as a guide for setting support prices.

Current Problems and Policy Goals

Since 1980 the dairy industry has struggled to get back to the way life used to be. Like the kitten in the tree, getting back down is not nearly as easy as getting up.

Congress has grappled with and changed dairy policy each year since 1980. Each new policy has been a bit harsher than the prior one. In April 1981, the semi-annual price increase required under 1979 legislation was suspended. In December 1981, support prices were essentially severed from the parity standard. Although not related to parity, small annual increases in support prices were permitted in the 1981 Agriculture and Food Act. In 1982 it became apparent that even the first small increase was unwarranted, given growing surpluses.

Amendments were added to the Omnibus Budget Reconciliation Act of 1982 which froze the support price at the level it had been since October 1980 and the Secretary was granted authority to directly assess farmers to help offset some of the program costs. Two assessments of 50 cents per ctw. of milk marketed were permitted. The first was nonrefundable; the second was refundable to farmers who reduced their markets.

In November 1983, a four-point compromise, reflecting each of the major proposals that had been advanced, was adopted. The Dairy Production Stabilization Act combined price cuts, a mandatory assessment, a mandatory promotion program funded by farmer assessments, and a "milk diversion program" which offered cash payments to farmers who agreed to market less milk than they had during a base period. It would appear that when surpluses first began to grow, Congress tried to do as little as possible, addressing first the principal budget concerns. By late 1983, Congress was apparently ready to try a little bit of everything.

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