

# Target Price-Deficiency Payments Program

**EDITOR'S NOTE:** This is the eighth in a series of nine articles about dairy policy options for 1985. Compiled by Jack Kirkland and Blair Smith, Extension and 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, and to help you take a more effective stand for the program you choose to support as the 1985 Farm Bill is formulated.

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

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Since it began in 1949, the dairy price support program has worked so smoothly in most years that we tend to forget that there are other ways of achieving dairy policy objectives. An alternative to purchasing manufactured products to support farm prices would be a target price-deficiency payments program.

## What Is a Target Price-Deficiency Payments Program?

Basically, a target price-deficiency payments program is one in which direct payments or deficiency payments are made to milk producers. Since there would not be a Commodity Credit Corporation (CCC) purchase program for butter, cheese, and nonfat dry milk, wholesale product market prices would adjust to market-clearing levels.

Producer milk prices would quickly reflect such adjustments. The amount of payment is the difference between the target price and the prevailing market price for producer milk.

Look at an example of deficiency payments that emphasizes the contrast with the present CCC purchase program. Assume that the purchase program is in operation, the support price for milk is \$12.31 (3.5 percent butterfat), and CCC purchase prices are \$1.43 per pound for butter, \$1.35 per pound for cheese, and 91 cents per pound for nonfat dry milk. Further assume that given these circumstances, the Minnesota-Wisconsin (M-W) manufacturing milk price for a given month is \$12.40 per cwt.

If the CCC purchase program had been replaced with a deficiency payments program for that same month, let us assume the following responses would have occurred:

1. The \$12.31 support price now becomes a \$12.31 target price.
2. In the absence of CCC purchases, wholesale prices for (a) butter drop 12 cents a pound, (b) cheese drop 10 cents a pound, and (c) nonfat dry milk drop 6 cents a pound.
3. As a result of the price declines in product markets, the M-W price for the month falls to \$11.40, a full \$1 lower than the \$12.41 reported under a purchase program.
4. With the competitive market price at \$11.40 and a designated target price of \$12.31, a deficiency payment of 91 cents per cwt. would be made.

## Alternative Mechanisms for Implementing Deficiency Payments

The target price for milk could be identical to the support price. It could be established by the same procedure, whether that be parity, dairy parity, cost of production, or some other standard.

Deficiency payments could be designated not just as a means of addressing farm income problems in the dairy sector, but also to control milk production. In the feed grains program, for example,

deficiency payments are used as incentives to participate in acreage reduction programs.

In dairy, deficiency payments 1) could be made available only to those producers who voluntarily agree to reduce marketings a certain percentage from a base, or 2) in a mandatory program could be refused to milk producers who fail to limit marketings to an amount below their base.

Some type of a deficiency payments-supply control program would probably allow higher target prices than deficiency payments without supply controls because program costs and effects could be controlled more tightly.

In a similar vein, deficiency payments could be limited or targeted to specific groups. Where deficiency payments have been used for other commodities, a \$50,000 payment limit per farm has been specified. With a payment limit, larger dairy operations with production levels that exceed the limit would be at a disadvantage.

As a rule of thumb, deficiency payments of \$1 per cwt. on all milk marketed would mean a payments ceiling of approximately 300 milk cows per farm if a \$50,000 limit was adopted. At the same time, milk production on smaller and possibly less efficient dairy farms might increase in response to the payments.

Another possibility would be to extend deficiency payments only to milk used for manufacturing. About 40 percent of the U.S. milk supply is utilized in beverage milk products—in Class I—so savings would be proportional.

Class I prices could be established by adding Class I differentials to the target price rather than the market clearing M-W price. Thus, producers in fluid milk markets would receive deficiency payments only on Class III milk and would get the full Class I price on Class I usage.

This transfers part of the cost of farm income supports from taxpayers to fluid milk consumers. There could be periods when Class I prices would be much higher than normal relative to Class III prices.

## Conditions Fostering Need for Deficiency Payments

There are several reasons why the target price-deficiency payments approach will be seriously considered. Easily the most important reason is that the market-clearing prices that are basic to this program would be demand sensitive, and lower prices could provide a significant boost to milk and dairy product sales in the long run.

The deficiency payments program would permit products to move through markets on a supply-demand basis, while CCC purchase prices hold wholesale prices up and thereby weaken demand for manufactured products. Also, the price advantage that some substitutes for dairy products now enjoy would be reduced substantially.

Closely linked to the demand stimulus that market clearing prices might generate would be new incentives to promote, merchandise, and market dairy products. The easy option of selling to the CCC would no longer exist. Proprietary firms and dairy cooperatives would be challenged to aggressively seek sales in competitive markets. Without an automatic government market, energies would be directed at expanding demand.

The deficiency payments approach would also link dairy price policy more closely to overall agricultural policy in the U.S. Critics say the dairy program in recent years has gone its own way—parity, purchases, no supply discipline.

Deficiency payments have been

a basic tool for cotton, wheat, and feed grains since the early 1970s. By adopting deficiency payments, the dairy sector could become an integral part of a more unified agricultural price-income policy.

A final consideration might be that target prices can achieve the price-income goals of the dairy program more reliably than CCC purchases. For example, in the 1981 through mid-1984 period, the competitive M-W price was usually below the support price by 20 to 30 cents per cwt. A deficiency payments program would not be subject to that kind of slippage because the difference between the target price and the market price would be measured directly and payments to farmers would be made accordingly.

## Consequences of Deficiency Payments

In the same way that CCC purchases ran into trouble because of high prices, 1985, to

1983, the deficiency payments approach is vulnerable on a cost basis too. For example, if 91 cents per cwt. payments were issued for annual marketings of milk of 135 billion pounds, the dairy program would cost nearly \$1.25 billion. When annual milk production is large, market clearing prices would be pushed to lower levels and deficiency payments would move to high and costly levels.

As was discussed earlier, program costs can be reduced by limiting payments or by transferring some of the cost back to consumers, as in the form of higher prices for Class I milk.

A very important short-run concern has to do with the disruption of the manufactured dairy products industry. The CCC purchase program is so institutionalized that processors of cheddar cheese, butter, and nonfat

dry milk would face major adjustments if purchases were abruptly terminated. The nonfat dry milk market in particular, the butter market to a lesser degree, and even the cheese market on occasion have become dependent on the CCC as a residual buyer.

Dairy cooperatives have taken on much of the responsibility for handling excess milk supplies in recent years, so they would be challenged to move products commercially and obtain prices for these products that would not disadvantage their members.

If a deficiency payments program was adopted, it might be desirable to phase out CCC purchases or to establish some kind of a market-wide service payment mechanism for all dairy farmers so that an equal cost sharing of the adjustment away from government purchases might be effected.

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