Mandatory Supply Management: A Dairy Policy Option

Why The Current Interest In Supply Management

Editor's Note: With this issue we begin a seven-part series that provides an overview of supply management as a policy option. The emphasis in the article. The articles focus on mandatory supply control programs due to the current interest in this area.

BY WALTER WASSERMAN
Cornell University

Over the last six years the dairy industry has been plagued with an overwhelming supply-demand imbalance. Milk production has increased by 20 billion pounds from 1979 to 1985, while commercial demand has increased by only half that amount. Government purchases under the price support program rose dramatically from 2.1 billion pounds of milk equivalent in 1979 to a peak of 16.8 billion pounds in 1983, at a cost exceeding 2.5 billion dollars for the year.

Record production, record USDA purchases of dairy products and record price support expenditures characterized the years from 1981 to 1983. Attempts at discouraging milk production during this period were centered primarily in the area of price support adjustments.

Then from 1983 to 1985, there was a period of policy innovation, as support price drops were combined with voluntary supply control programs in a further attempt to reduce government purchases and expenditures.

Milk prices received by farmers fell $2.12 per cwt between May 1981 and May 1986 after adjusting for deductions. The effective all milk price for May 1986 was $11.38 per cwt, the lowest price in eight years.

Dairy farmer equity has deteriorated as well and the question being raised is, "What will it take to bring the dairy industry back to a long-term equilibrium condition, with milk supply and demand in reasonable balance and farm milk prices that will afford a reasonable return to labor and capital?"

Some will answer that mandatory supply controls are the only option remaining, while others will argue just as vehemently that controls or quotas are not the answer.

Dairy Policy Review 1982 to 1985

At the beginning of 1982, support prices were established in accordance with the Agriculture and Food Act of 1981. This Act specified a support price of $13.10, at 3.67% fat test, through September 1982 and $13.25 from October 1982 through September 1983, unless support purchases or expenditures dropped to specified levels which would trigger higher prices based on 70 or 75 percent of parity.

The inadequacy of this policy became obvious almost immediately and the search began for an alternative.

In late August 1982, Congress passed legislation changing support policy under the Omnibus Reconciliation Act This Act attempted to reconcile the differences between advocates of a simple cut in the support price (e g , the administration) and those who favored a more complex plan involving a two-tiered base-excess pricing scheme (e.g., National Milk Producers Federation).

Congress froze the support price at $13.10 through September 1984 and gave the Secretary authority to directly assess producers up to one dollar per hundredweight (in two 50-cent increments), provided projected price support purchases did not fall below certain levels.

Opposition to this modified price support program came from all segments of the dairy industry and all around the country, despite the fact that the program reduced the farmers' effective price less than most of the alternatives.

This general dissatisfaction with the existing legislation led to passage of the Dairy Production and Stabilization Act in the fall of 1983. The DPSA initiated a set of program changes and a sequence of events without precedent. The DPSA combined four major actions.

First, it lowered the support price by 50 cents per hundredweight as of December 1983, and it authorized further reductions of 50 cents per cwt in April and July of 1985.

Second, it authorized a direct assessment of 50 cents per cwt against all farm marketings of milk from Dec. 1, 1983 through March 31, 1985.

Third, it offered payments of $10 per cwt of milk "diverted" to farmers who agreed to sell less milk in 1984 and the first quarter of 1985 than they did during a base period.

Fourth, all farmers were required to contribute 15 cents per cwt of milk marketed to a National Dairy Promotion and Research Program, although credits of up to 10 cents per cwt were allowed for contributions to similar regional or statewide programs.

The Milk Diversion Program, as it was known, was successful in reducing 1984 milk production by 4 billion pounds and government purchases under the price support program by 8 billion pounds, but its success was short lived. Milk production began to increase sharply as soon as the program terminated in March 1985, culminating in another record year. U.S. milk production topped 143 billion pounds in 1985, and although commercial sales continued to improve, CCC purchases increased by 53 percent.

The 1983 farm bill expired on Oct. 1, 1985, but Congress failed to deliver a new policy on schedule. The House and Senate conferees finally agreed on the provisions of the 1985 Farm Bill on Dec. 14, 1985. The bill was approved by both the House and the Senate the following week and was signed into law by the President on Dec. 23.

The "Food and Security Act of 1985" covers a period of five years, through calendar 1990.

The major dairy provisions of the Act include: an $11.60 support price through December, 1986. Price supports at $11.35 from Jan. 1 to Sept. 30, 1987 and at $11.10 on Oct. 1, 1987. On Jan. 1, 1988 and every January thereafter, the support price may be reduced by 50 cents if net removals by the government are projected to exceed 5 billion pounds. In addition, the bill authorized the Secretary of Agriculture to initiate a Dairy Termination Program by April 1, 1986.

The objective of the program was to reduce milk production by 12 billion pounds Producers submitted bids which, if accepted, provided them with a payment in return for ceasing milk production for a five-year period The bill also provided for an assessment of 40 cents per cwt on all milk as of April 1, 1986 and a reduced assessment of 25 cents per cwt from January 1 to Sept 30, 1987 Additionally, there were provisions that raised Class I differentials in 35 Federal Order markets, provided for the establishment of a national dairy commission, and addressed a number of other dairy concerns.

The DTP was successful in retiring 12.28 billion pounds or 8.7 percent of the milk marketed in 1985, thus fulfilling its primary goal Our preliminary projections indicate that the program will have a positive impact in reducing milk supplies and increasing farm milk prices during the summer and fall of 1986 and 1987. The greatest uncertainty pertains to the period 1988 to 1990, at which time the current legislation falls back on the disincentive of lower price supports to curtail supply-demand imbalances. There seems to be great skepticism among some segments of the industry that these provisions will be able to sustain a balanced market.

U.S. Supply and Use of Milk

	1983	1984	1985	1986*	1987**
Production	139.7	135.4	143.7	145.1	142.0
Farm Use	2.4	3.1	2.6	2.3	2.3
Marketings	137.3	132.3	141.1	142.8	139.7
Beg. Comm. Stocks	4.6	5.2	4.9	4.6	5.1
Imports	2.6	2.7	2.8	2.9	2.8
TOTAL	144.5	140.2	148.8	150.3	147.6
Comm. Dis.	122.5	126.7	131.0	134.8	137.0
End. Comm. Stocks	5.2	4.9	4.6	4.8	5.2
Net Removals	16.8	8.6	13.2	10.7	5.4
TOTAL	144.5	140.2	148.8	150.3	147.6
Farm Price All Milk	$13.57	$13.45	$12.73	$12.25	$12.30
NY-NJ Blend	$13.23	$13.03	$12.32	$11.98	$12.00
Avg. Annual Assessment	$ .48	$ .50	$ .13	$ .36	$ .19
Eff. Price	$12.75	$12.53	$12.19	$11.62	$11.81

1986 adjusted for DTP & G-R-H (through September 30, 1986).
*Projected.
**Forecast.

The Supply-Demand-Price Outlook

At the present time, indications are that the current dairy policy and market conditions are in fact bringing supply and demand into better balance.

In July, U.S. milk production declined by 1 percent from year earlier levels following increases of up to 7 percent during the first quarter of the year. Milk cow numbers continued to decline for the seventh consecutive month, reflecting the DTP and dairy price policy. July cow numbers were down 2.3 percent from July, 1985.

Even more significant in the long run is a 6 percent decline in the number of dairy replacements on farms on July 1. By the end of July, 642,000 dairy cattle had been removed from farms under the DTP.

Commercial disappearance has continued to increase dramatically. For the first six months of 1986, commercial disappearance increased 4.2 percent compared to the same period in 1985. Lower milk production, moderate increases in commercial sales and sharply lower government purchases are forecast for 1987.

There are a number of factors, however, that could lead to a deterioration of these favorable market conditions by 1988. Low feed prices and, or the introduction of bGH could stimulate greater production increases, particularly as milk prices strengthen while weakness in the economy could curtail further growth in demand.

The continuing threat of still lower support prices leading to further price instability and low returns to dairymen is fueling the interest in mandatory supply control as a dairy policy option.

(continued next week)

Alternative Voluntary Supply Management

BY HARRY KAISER
Cornell University

This educational series is primarily concerned with analyzing the range of mandatory quota programs as alternatives to current dairy policy. However, it is important to recognize that mandatory quotas are not the only type of supply management program available for "managing" our milk supply.

To add a broader perspective of the concept of supply management to this series of publications, this article describes the general notion of supply management, and several forms of voluntary supply management programs that have been proposed for national dairy policy over the last several decades.

Supply Management Programs

Interest in supply management almost always develops when supply begins to outpace demand In order to bring demand and supply into balance, policy prescriptions tend to emphasize supply rather than demand adjustments, with producer finance promotion programs as an exception to this rule.

The reason for this is simple. Demand for milk is quite stable — easy to forecast, but difficult to alter in the short run. It is hard to increase demand because of the difficulty in changing consumers' tastes, preferences and habits.

Supply, on the other hand, can be controlled more readily through government programs that offer producers economic incentives, or disincentives, to encourage a desired level of production. By offering producers incentives, or disincentives, the government can adjust production to be more in line with consumption. In the past, U.S. dairy policy has always resorted to voluntary supply management programs or adjustments in prices to control production.

Although the term "supply management" has been used frequently in recent discussions about alternative dairy policies, it is difficult to find a standard definition of what this phrase means. The term has come to mean different things to different people.

For example, some have used it synonymously with specific programs like the Milk Diversion Program, Dairy Termination Program or milk quotas. Others have interpreted supply management more generally to mean any policy designed to balance supply with prevailing demand. The more popular definition of supply management is supply control.

An important distinction between alternative types of supply management programs is whether producer participation is voluntary or compulsory.

Voluntary programs seek to adjust total production in relation to projected consumption by providing economic incentives to dairy farmers for voluntarily cutting back or ceasing production. Because they are not compulsory, these programs must make the incentives strong enough to encourage a sufficient number of farmers to participate in order to bring supply into adjustment with demand.

Mandatory programs (e.g., quotas) seek to limit total production by penalizing those who produce in excess of their assigned bases. Penalties have to be severe enough to discourage the majority of farmers from exceeding their quotas, ranging in severity from receiving a lower price to no price at all on any milk sold over one's quota. The effects of a quota plan on income and production depends on the period on which quotas are based, how frequently they are adjusted, and whether they are transferable.

While voluntary programs have been implemented in the past to reduce milk production, a national compulsory program has never been established in the U.S. One reason is that mandatory programs would be a radical departure from past and current dairy policies that allow farmers complete freedom in determining how much to produce.

Alternative Voluntary Programs

Over the past 20 years, several voluntary programs have been proposed and some adopted in an attempt to reduce surpluses in milk production. One common element of all these programs is the fact that they were designed to work with (as opposed to being a replacement for) the two principal U.S. dairy programs: Price Support Program and Federal Milk Marketing Order Program.

Generally speaking, the PSP indirectly supports the price of milk through government purchases of butter, nonfat dry milk, and cheese to enable manufacturers to pay the support price for milk purchased from farmers.

The FMMOP promotes "orderly" marketing conditions by requiring milk handlers to pay

(Turn to Page A21)