

# Mandatory Supply Management: A Dairy Policy Option

## The California Milk Quota System

BY EDWARD V. JESSE

University Of Wisconsin-Madison

While a national mandatory quota program has never been adopted in the United States, California, the second leading dairy state, operates a quota program for fluid milk. It is very different from the quota systems in Canada and the EC in that the California plan applies solely to milk sold for fluid products.

The California program uses quotas to assign marketing rights to the higher-priced fluid market. Producers are paid different uniform or blend prices depending on their production relative to individual quotas and production bases.

### Conditions Leading to the California Quota Program

Prior to 1968, California Grace A or market milk producers contracted with plants for specific volumes of milk. Administered pricing in effect in California since the 1930s, set higher minimum prices for fluid milk, so producers contracting with plants having high fluid utilization fared well compared to neighbors with identical quality milk who contracted with low-utilization plants.

Competition was considerable among producers for contracts with high fluid utilization plants, who held the upper hand in negotiating non-price contract terms like hauling rates.

To address equity problems in allocating fluid milk sales among eligible producers, the California Legislature passed the Gonsalves Milk Pooling Act in 1967.

Under the Act, which became effective in late 1968, each licensed market milk producer was assigned a production base and a Class I quota. These were based on daily average milk sales during either 1966 or 1967.

Because California has used component pricing for milk sales since 1972, the production base was total fat and solids-not-fat sales expressed on a daily basis. Class I quota was fat and SNF sales under contract to fluid handlers.

Due to widely-varying fluid sales opportunities under the contract system, quota as a proportion of production base differed substantially among market milk producers.

To rectify these differences, 80 percent of any increase in Class I quota was to be allocated to existing producers according to their quota/production base ratio, with the remainder going to new entrants. Hence, as increases in fluid sales occurred, additional Class I quota was granted to market milk producers in inverse proportion to their ratio of quota to base.

The intent was to "equalize" all market milk producers at a ratio of 95 percent.

To speed the process, a blanket allocation of new quota was made in 1978 to equalize all producers holding production bases at that time. This brought the total amount of quota well above the amount needed to meet fluid milk requirements, a situation that persists today.

### Components of the California Program

California milk quotas and bases do not restrict total milk production, but producers receive different prices for quota, base, and over-base milk. At the state level, these prices depend on how much of total producer milk is used in each of four utilization classes: fluid (Class I), soft products (Class II), ice cream/frozen products (Class III), and hard products (Class IV).

Quota milk is assigned to the most valuable use class for pricing purposes.

Over-base milk, which is milk production in excess of production bases, is assigned to the lowest class.

Base milk, which is production base minus quota, is assigned to the residual classes.

This procedure sounds very complex so an example will help clarify how farm milk prices are calculated. Suppose California milk use by class for some month is as follows:

Utilization Class	Price	Percent Used
1	\$13.00	45
2	12.00	7
3	11.50	5
4	11.00	43

Now, suppose producer marketings for the same month are distributed as follows:

Quota Class	Percent of Marketings
Quota	50
Base	20
Overbase	30

Then, the prices for quota, base, and overbase milk would be calculated as follows:

Quota Price:	$(45\% \times \$13) + (5\% \times \$12)$	= \$12.90
Overbase Price:	$(30\% \times \$11)$	= \$11.00
Base Price:	$(2\% \times \$12) + (5\% \times \$11.50) + (13\% \times \$11)$	= \$11.23

In other words, the quota price is calculated by starting from the top down in terms of allocating milk value. The overbase price is calculated by starting from the bottom up. What's left over is allocated to base milk to establish its value.

These prices for quota, base, and overbase milk would be the same for all market milk producers at the same location and with comparable milk quality and composition. But the blend price received by a producer would depend on how much of the producer's milk fell into the three categories.

A producer whose milk composition was 90 percent quota milk and 10 percent base milk would receive \$12.73 per hundredweight in the above example ( $.9 \times \$12.90 + .1 \times \$11.23$ ).

A producer with 50 percent quota milk, 20 percent base milk, and 30 percent overbase milk would receive \$12.

Similar to the Canadian program, quotas may be traded among California market milk producers. Quota sales are expressed in dollars per pound of SNF per day.

Prices vary with several factors, including the number of pounds of quota fat per pound of SNF (normally around 0.4 pounds but different among producers), the amount of production base tied to the quota, and whether cows are sold along with the quota.

However, the most important factor affecting quota prices is the difference in value between quota and overbase milk.

This value difference becomes capitalized in quota prices. For example, the difference in price between quota and overbase milk in May 1986 was \$1.70 per hundredweight (based on average fat and SNF composition).

The average price for quota transfers in May 1986 (quota price without cows) was \$276 per pound of SNF per day.

At 8.7 pounds of SNF per hundredweight of milk, this translates to a cost of \$2,400 per hundredweight of whole milk per day. In other words, the investment necessary to obtain \$620.50 in added milk revenue per year (\$1.70 x 365 days) was \$2,400. That reflects a 26 percent annual rate of return.

At the \$276 per pound of SNF quota cost, it would have cost about \$1,000 to purchase quota equivalent to the average daily SNF production of one dairy cow producing 15,000 pounds of milk per year.

### Experience with the California Program

Unlike federal order blend pricing, the California system provides a price incentive for individual producers to control production. Under federal order pricing, all production is priced at the marketwide blend price.

In contrast, production in excess of a California producer's production base is priced at the overbase price. If the overbase price is below marginal production costs, then the California producer would be induced to cut back to production base levels.

However, compared to the Canadian and EC programs, California's overbase milk price is quite high. The price for milk sold over-quota in Canada was equivalent to only 11 percent of their price support in the 1985-86 marketing year.

In Europe, the price received for over-quota milk is 25 percent of the price support. In recent years, the dairy price support program has yielded a price for overbase milk that has been high enough to cause a substantial increase in California milk production, much of which has been sold to the Commodity Credit Corporation as butter, powder and cheese.

In the 1984-85 marketing year, October to September, California was the leading state in Commodity Credit Corporation sales of butter and nonfat dry milk; third in cheese.

Thus the California quota system has not balanced milk supply with demand.

For some time, California producers have found it profitable to expand production of overbase milk, even though the overbase price has been below the federal support price.

For instance, in May 1986, the California overbase price (average fat and SNF composition and prices) was \$10.66 per hundredweight. The comparable support price in the same month was \$11.31, and the M-W price (average Grade B price in Minnesota and Wisconsin) was \$10.98.

## SEED and FERTILIZER LOANS

**8 1/2%**  
Annual Percentage Rate

If you need help to purchase seed and fertilizer, check out our 12 months, 8.5% fixed rate loan.

Quarterly interest payments.

### New Holland Farmers National Bank

NEW HOLLAND, SMOKETOWN, INTERCOURSE, EDEN RD, LANCASTER.

MEMBER FDIC

EQUAL OPPORTUNITY LENDER

Main Office: 210 East Main St., New Holland, PA 17557

Please Check  
Next Week's  
Issue for  
Year End  
**INVENTORY  
SALE!**

**PAUL B. ZIMMERMAN, INC.**  
295 Woodcorner Rd., Lititz, PA 17543  
PH: 717-738-1121