Mandatory Supply Management: A Dairy Policy Option

Components And Implications Of A U.S. Mandatory Quota System

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Mandatory supply management programs involve the use of some type of production or marketing allotment or quota. The programs are mandatory because they are applied to all producers of a specified commodity and not just to those producers who individually elect to participate in such programs.

National dairy pricing programs in the United States have never included mandatory supply controls. Supply controls have been an important element in the debate that has surrounded the formulation of national dairy pricing policy. In this leaflet, the features and impacts of a national quota program are investigated.

Existing Dairy Price Programs

Price support has been the key element of dairy price policy from its beginning in the 1920s. Price support has been achieved primarily through the purchase of dairy products by the government, although voluntary supply management programs have supplemented purchase programs on several occasions.

During the 1930s, purchases of dairy products to support milk prices were very modest, exceeding one billion pounds of milk equivalent in only one year. Since 1949 purchases have been made each year to support market prices.

Market prices were maintained near support levels throughout the 1950s and 60s. Since the 1970s, market prices have deviated more (both up and down from support levels) than in the earlier periods.

Support purchases exceeded 10 billion pounds of milk equivalent in 1954, 1962, 1981, 1982, 1983 and 1985. These peaks in support purchases triggered legislation that modified the dairy support program and stimulated debate of alternatives to the program.

Mandatory supply management was an important element in the debate following each peak in support purchases, particularly in the 1960s and 1980s.

Features of a Mandatory Supply Management Program

A mandatory supply management program is a production control program in which all dairy farmers would be assigned a base, and there would be a substantial *penalty* price for marketings of over-base milk. Federal legislation would be necessary to adopt such a plan.

Neither states nor dairy cooperatives have the ability to address the national supply-demand-price issue with their own versions of base plans.

There are two fundamental purposes that a national quota program would be directed to achieving: to balance supply and demand, and if possible, at a price level high enough to permit average dairy farmers to enjoy a satisfactory level of living; and to permit dairy farmers to hold onto their individual share of the total milk market and not have the expansion of other dairy farmers reduce the price level and dilute their market share.

Supply management has a solid economic foundation, geared to the principle that the demand for some dairy products (particularly fluid milk products) is price inelastic. That is, consumers do not respond in any substantial measure to whether prices go up or down — they still will purchase close to the same amount of dairy products.

By restricting supply, milk prices can be increased, and yet demand will not be adversely affected in any major way. The net results is higher producer income.

Mandatory supply management could reduce the costs of the current price support program and alleviate problems of storage and disposition of dairy products. Given probable program costs and budget restraints, mandatory quotas may receive greater consideration in the future.

Most features of the current price support program would be continued with a quota program. A target price would need to be established each year and a purchase program for dairy products would continue to be necessary. Distribution programs would be needed to utilize dairy products that were acquired under the program.

Other additions to the current program would include:

- Procedures for establishing a national quota and for allocating the national quota to individual dairy farmers.
- An over-quota price and procedures for determining it would need to be established.
- Rules for transferring and reallocating quotas would be needed.

These features of a quota program could be accomplished in a variety of ways. The details of these features would affect the effectiveness and the impact of the program. The following illustrates how these features might be determined.

Establishment of Quotas

A national milk quota might be determined by estimating the total commercial demand for milk and adding the quantity of milk needed for domestic and international distribution programs. A reserve might be added to this total.

The national quota might be allocated to individual producers by relating it to the quantity of milk marketed by farmers in a designated base period. This base might be a 12-month period or the annual average of a longer period. If the annual national quota was 90 percent of total marketings by producers in the base period, the quota allocated to individual producers would be 90 percent of each producer's marketings during the base period.

The national quotas could be reduced gradually over a period of years from near the base period level to a level that would balance milk supplied closely with total market needs. Gradual reduction would increase program costs.

Over-Quota Prices

For the program to be effective in curbing the expansion of milk production or cutting it back, the over-quota price would need to be low enough to discourage over-quota production. A low over-quota price would be needed to finance the purchase and disposition of dairy products associated with over-quota milk.

The penalty for over-quota milk in the EC program is 75 percent of the target price.

Under the Canadian program, the over-quota price was only 11 percent of the quota price for the 1985-86 marketing year.

Quota Transfer Rules

Quotas could be freely transferable or saleable with or without geographic limitations.

Transfer could be highly restricted as in the EC program where transfer of quotas is permitted only when a farm is sold, leased or transferred by inheritance. Sale or lease of annual quota rights might be permitted without authorizing the sale of quotas themselves.

A wide difference between quota and over-quota price would give quotas or annual quota rights significant value if they were saleable. Both the Canadian and EC programs take back a portion of the quota whenever quotas are transferred.

The acquired quota could be allocated to new or existing farms to facilitate expansion.

Quota rules could require producers to fulfill a specified percentage of their quotas monthly. If they failed to do so the unfilled quota could be taken from them and transferred to other producers.

Permitting the sale of annual quota rights would help to insure that the national quota would be filled each year and would serve to limit over-quota sales.

Impacts of Mandatory Supply Management

The impacts of a quota program would depend importantly on the details of the program and whether it was temporary or permanent. Since a specific program has not been proposed, only general observations can be made about the impacts of a quota program at this time.

Use of quotas could maintain milk supplies in closer balance with demand over time. More particularly, the periodic large surpluses that have characterized the dairy industry could be avoided.

Government program costs could be reduced in part by shifting these costs to milk producers through assessments and to consumers through higher prices for milk/dairy products.

If transfer of bases were restricted, existing resource patterns would be frozen, innovation retarded and productivity gains limited. This would not be a serious problem if the program was temporary and used to eliminate an existing surplus problem.

Quotas would have little market value under these circumstances

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