

# Mandatory Supply Management: A Dairy Policy Option

## Farm And Market Level Consequences Of Supply Management Programs

BY ROBERT E. JACOBSON  
Ohio State University

As the previous articles have suggested, U.S. programs have always managed the supply of milk through the price mechanism.

Our objective was to gain some kind of a reasonable supply-demand balance, and the support price was adjusted up or down depending on whether milk was expected to be in short supply or in surplus.

But in the 1980s, the milk industry has been confronted with chronic surpluses that are larger and more costly than most people are willing to accept.

Embryo transplants, bovine growth hormone, iso-acid supplements and a number of other technological breakthroughs suggest that there will be increasing supplies of milk at relatively low costs. As a result, increasing attention is being directed to a mandatory supply management approach.

Given the background of the previous articles, this seventh and final article examines the farm and market level implications of a mandatory supply management program.

### Farm Implications

Probably the stickiest elements of a mandatory supply management program come down to who holds title to the base and what kind of base transfer rules are in place.

Farm-level implications vary depending on how such rules are defined. For example, is title to base held by the dairy farmer (Canada) or is it assigned to the farm (Europe)? Can bases be

transferred among dairy farmers (Canada), or is base transfer not permitted (U.S.—whole herd buyout base)? The usual view of supply management reflects the Canadian approach—bases assigned to the dairy farmer, and transferable.

A frequently voiced objective of dairy price policy is to "save the family dairy farm." Supply management has been promoted as a method to accomplish that purpose. But the Canadian version of supply management has neither slowed nor stopped the trend to fewer and larger dairy farms.

In the past decade, the number of dairy farms in Canada has declined by 44 percent, while the number of farms with milk cows in the United States has dropped by only 35 percent.

The Canadian experience does not mean, however, that supply management will not help save the family dairy farm.

Part of the reason for Canada's continued dairy farm concentration is found in their rules for base transfer. Title to base is held by the milk producer, and he is free to sell his base or to purchase additional base from other milk producers. The net effect of these provisions has tended to encourage some producers to sell out and others to get larger.

### Rules and Regulations

If we were to adopt a base plan in this country, we would not have to follow Canada's path.

We could establish rules in which the government essentially holds title to the base, and no base transfer among producers would be permitted.

The government would allocate base and reallocate base by prescribed rules. The base of a retiring producer would revert to the government. Such arrangements could slow the trend to fewer and larger dairy farms.

Assuming base transferability, bases take on substantial value because they represent a privilege to market milk and to receive a significantly higher price for the base amount of milk.

Therefore, the value of base becomes an asset in the farm balance sheet and an additional cost in the schedule of production costs.

With a supply management program, with its price and quantity specifications at the farm level, questions arise concerning the impacts on milk production efficiency and resource allocation. Without supply management, it is assumed that competitive market equilibrium prices adjust resources and encourage efficient milk production.

If bases are transferable under a supply management program, most of the questions concerning milk production efficiency and economic resource allocation are resolved. Dairy farmers would buy base to expand and sell base as they retire in many instances.

The question of allocating base to new producers must be addressed, but it poses no major problems if the total market is increasing. Knowing that the amount of milk that they can market at a desired price is fixed by the base, milk producers would shift their decision-making emphasis from that of growth and expansion to that of cost

minimization for the quantity they can market.

If bases are not transferable, the efficiency questions become more critical. Higher cost producers would have very little incentive to exit from dairying and, in effect, would be subsidized by the higher base price.

Adoption of new technology would be slowed, and the entire industry would be less competitive. The burden of fine tuning the quota program in ways that would continue to invite progress and efficiency would be in the hands of government.

Regionalization would emerge as a major consideration in the adoption of a supply management program.

Historically, the use of Commodity Credit Corporation purchases of butter, cheese, and nonfat dry milk to support the price of producer milk has permitted us to view dairy price support as a single national program without significant regional ramifications. But mandatory supply management would force a change in that view. For example, Class I utilization ranges from less than 20 percent in the upper midwest to higher than 80 percent in the southeast.

If a quota program provided for a uniform cutback in supply across the nation, some areas would be short of fluid milk supplies while other areas would be affected very little. We have already observed some regional supply problems in the voluntary diversion and whole herd buyout programs.

Mandatory supply management would force regional differentiation.

### Market Implications

Most of the market implications of a mandatory supply management program are geared to the higher price level that the program would establish. While the demand for milk may be price inelastic, it still responds negatively to higher price levels.

The milk industry in the U.S. has enjoyed a remarkable increase in commercial demand in the 1980s, and it is reaching a new record of 135 billion pounds in 1986.

Some of that demand vigor is explained by the 15-cent per hundredweight promotion assessment, and some of it is explained by relatively low retail prices for milk and dairy products. Higher prices could dampen the recent strength in commercial demand and remind us again of the continuing substitution issue confronting the milk industry.

Since mandatory supply management could essentially be programmed to balance supply with demand, the problem with dairy surpluses would virtually disappear.

Government purchases of dairy products would occur only on a seasonal or sporadic basis, depending on what the program authorized. As a result, the costs of the dairy program, which have been in the \$2 billion a year range in most of the 1980s, would be reduced to minimal levels.

### Cooperatives

Many dairy cooperatives would face major operating adjustments under mandatory supply management.

Dairy cooperatives have built

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