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DAIRY POLICY FOR THE 1990 FARM BILL:
STATEMENT TO THE U.S. HOUSE SUBCOMMITTEE
ON LIVESTOCK, DAIRY, AND POULTRY

Andrew Novakovic

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Preface

This paper is a formal statement that was presented at a field hearing of the House Agriculture Subcommittee on Livestock, Dairy, and Poultry. The hearing was held in Syracuse, New York on 10 January 1990.

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Introduction

The dairy community in New York is pleased and proud to host a field hearing of the Subcommittee in Syracuse and is grateful to Mr. Walsh for bringing the Subcommittee back to one of the nation's leading dairy states. While the rest of the country may find it hard to imagine, please be assured that the dairy industry is an important component of the economy in this state and the Northeast. Although New York and the Northeast is better known for its large urban population, this area also has a very large rural population. To be sure, only a fraction of the rural population is comprised of dairy farmers, but the rural community is very much affected by the production and marketing of milk and dairy foods. Dairying is, of course, far and away the largest segment of agriculture in this region. Historically, the development of the U.S. dairy industry began in the Northeast and to this day our dairy industry is a large, leading, and vital segment of the U.S. dairy sector.

The formal remarks presented below will begin with a discussion of what is presently occurring in national dairy markets and the factors that are likely to be important as we enter the new decade. Leading dairy policy options will be reviewed in light of these expectations and the objectives of dairy policy.

Three key points will be made. First, the extremely tight markets of 1989 notwithstanding, the underlying potential of the nation's dairy farmers to increase milk production is still somewhat greater than our potential to increase commercial sales of dairy products. Thus, there still exists a need to construct dairy policy with an eye toward the possibility of future surpluses. Second, although the problem of overall surpluses is certainly one we need to keep in mind, the larger policy challenge is likely to be how we deal with the enormous and growing divergence between the nation's most profitable dairy farmers and the least profitable. Third, we need to be thinking creatively but seriously about how dairy policy and the dairy industry will relate to the several larger issues confronting commercial agriculture, such as soil and water conservation, rural revitalization, and global trade. None of these issues may appear to be urgent, but they are important.

The U.S. Dairy Situation and Outlook

Milk Supplies

As in the saying, milk production in 1989 began with a bang and ended with a whimper. Cow numbers were consistently down about 1.2% to 1.3% each month, but production per cow, and consequently total production, began strong and slowed substantially in succeeding months. Milk production per cow in 1989 began with a substantial year to year increase, but by July, production per cow fell below 1988 levels. For the year, it is estimated that production per cow will still increase by an average of 145 pounds per cow, or 1% higher. When this is adjusted for the fact that 1988 was a leap year, the gain becomes about 1.3% on a daily average basis. This is about half the normal annual gain. Milk production for the year is estimated to be about 0.2% less than

1988, as shown in Table 1. If one adjusts for the fact that 1988 was a leap year, the estimated decrease becomes a 0.1% increase on a daily average basis.

All of the major milk producing states followed the national monthly pattern, except California and Washington. Washington's 2.9% increase for the first eleven months of 1989 reflects a nearly constant year to year gain in every month. For the same period, California milk production dipped in the second quarter, recovered in the third quarter, and totaled an increase of about 4.6%. Gains in milk production in Texas have slowed throughout the year, but Texas production was still well above year earlier levels late in 1989. With a total gain of 7.1%, it has increased faster than any of the major milk producing states. In fact, Texas production exceeded Ohio's in 1988, and the Lone Star state will overtake Michigan as the sixth ranked milk producing state in 1989.

Milk production in New York, Pennsylvania, and New England is down 1%, 1.3%, and close to 2% through November 1989, respectively. Showing trends just a little lower than the U.S. average, New York and New England have drifted down relatively slowly from the beginning of the year. Pennsylvania started the year with gains more than twice the U.S. average and in the third quarter it was declining faster than it had been gaining during the first quarter.

Milk production is down in Wisconsin (-3.1%), Minnesota (-2.4%), Michigan (-1.1%), Ohio (-1.4%), and Illinois (-2.0%). It is up in Iowa (3.4%) and Missouri (1.7%). Although the latter two stand out simply because they are counter to the national trend, the most noteworthy among these states is Wisconsin. The sharp drop in 1989 stands in marked contrast to the earlier pattern of modest but steady milk production gains in Wisconsin, and it may be the single most important factor driving basic milk prices.

For 1990, a recovery in milk production is expected by every dairy analyst, but there is disagreement about when it will start and how big it will be. We are projecting a fairly strong recovery of about 1.9%, with some increase in cow numbers as well as gains in production per cow.

Milk Utilization

Through September, 1989, USDA reports that commercial disappearance of all milk (milk equivalent) in 1989 is 0.8% below year earlier levels. As shown in Table 1, our estimate of 136.6 billion pounds for all of 1989 would place commercial disappearance below 1988; on a daily average basis it is 0.1% less than 1988.

Commercial disappearance of butter is off almost 13% through September; ice cream is down 4%; and cottage cheese is down 6.8%. Cheeses are up over 6% through September. Ice milk, probably masquerading as "light" ice cream, is up 3.4%. Fluid milk products have been doing quite well this year and are up 1.4% through September. The startling story of 1989 is the huge increase in commercial use of nonfat dry milk, up 33% through September.

Total disappearance is calculated on a milkfat basis, i.e. the milk equivalent is determined by the amount of milk necessary to yield the milkfat contained in the various individual dairy products. The change in total disappearance is very much affected by the decline in sales of butter and other dairy products which are generally higher in fat. At the other extreme,

Table 1
U.S. Milk Supply and Utilization
1982-1990

	1982	1983	1984	1985	1986	1987 ^a	1988 ^a	1989 ^c	1990 ^d
Supply									
Cow Numbers (thous.)	11011	11098	10833	11016	10813	10329	10239	10120	10148
Production/Cow (lbs.)	12306	12585	12506	12994	13260	13802	14213	14358	14580
	(billion pounds)								
Production	135.5	139.7	135.4	143.1	143.4	142.6	145.5	145.3	148.0
Farm Use	2.4	2.4	2.9	2.4	2.4	2.3	2.2	2.2	2.2
Marketings	133.1	137.3	132.5	140.7	141.0	140.3	143.3	143.1	145.8
Beginning Commercial Stocks	5.4	4.6	5.2	4.9	4.6	4.2	4.6	4.3	4.2
Imports	2.5	2.6	2.7	2.8	2.7	2.5	2.4	2.4	2.3
TOTAL SUPPLY	141.0	144.5	140.5	148.4	148.3	146.9	150.3	149.8	152.3
Utilization									
Commercial Disappearance	122.1	122.5	126.9	130.6	133.5	135.6	137.1	136.6	137.7
Ending Commercial Stocks	4.6	5.2	4.9	4.6	4.2	4.6	4.3	4.2	4.3
Net Government Removals	14.3	16.8	8.6	13.2	10.6	6.7	8.9	9.0	10.3
TOTAL USE	141.0	144.5	140.5	148.4	148.3	146.9	150.3	149.8	152.3

Source: Dairy Situation and Outlook, Milk Production, and Dairy Market News, U.S. Department of Agriculture.

^a Revised.

^b Preliminary.

^c Based on preliminary USDA data and Cornell estimates.

^d Projected by Andrew Novakovic.

nonfat dry milk sales have no impact whatsoever on USDA estimates of total disappearance. Recognizing the switch that seems to be taking place from higher fat to reduced fat and no fat dairy products, the traditional measure of dairy product sales is conveying a much more gloomy picture of sales than is warranted.

For 1990, we project a slight recovery in commercial disappearance of less than 1%. As with 1989, this modest gain in the standard sales measure belies what should be another good year for lower fat dairy foods and cheeses.

Price Support Program

Net removals of dairy products under the dairy price support program (DPSP) are estimated to be slightly ahead of the 1988 level, ending 1989 at about 9 billion pounds (m.e.). This represents over 6% of the milk produced in the U.S. Or does it? For the same reason that the conventional measure of disappearance understates commercial sales, the milk equivalent measure of net removals overstates what has been sold to the government under the DPSP.

Since the end of July 1988, there have been no DPSP sales to USDA of nonfat dry milk, and sales of cheese have been minor. Sales of butter at 422 million pounds in 1989 exceed the record of 413 million pounds established in 1983. The amounts of cheese and nonfat dry milk are far below what was sold under the DPSP in other years when milk equivalent sales were as high as they are now.

For 1990, our projection of a somewhat larger increase in production than consumption results in an increase in milk equivalent net removals. Butter will still dominate sales to the government, but sales of cheese could be somewhat higher too. By Spring, 1990, we may well see some seasonal sales of nonfat dry milk to the CCC. NDM sales could be fairly large for a few weeks, but this should not be cause for alarm. They are not expected to be a terribly important factor for the year.

Milk Prices

As shown in Table 2, farm milk prices in 1989 are estimated to average \$1.16 per cwt higher than 1988. The benchmark M-W price (at 3.5% milkfat) bottomed out at about \$11.00 in March and April then rose rapidly to a record shattering peak of \$14.93 in December, 1989. These levels were reflected in milk prices throughout the U.S. Figure 1 compares the M-W price to the support price during the 1980s.

For 1990, exceptionally strong prices early in 1990 will hold the annual average farm price near or above the 1989 average. Forecasts range from a higher average price in 1990 to much lower prices, depending on whether it is thought that production gains or strong demand will dominate. In either case, farm prices are expected to be determined more by market forces than by price supports.

Wholesale prices for butter in 1989 for the most part followed the 5¢ to 6¢ decline in the average purchase price set by USDA. Market prices for butter will follow the CCC purchase price down 10¢ in January, 1990. Despite

Table 2
Farm Prices for Milk;
CCC Purchase, Wholesale, and Retail Prices for Cheddar Cheese, Butter, and Nonfat Dry Milk;
and Selected Retail Price Indices
1982-1989

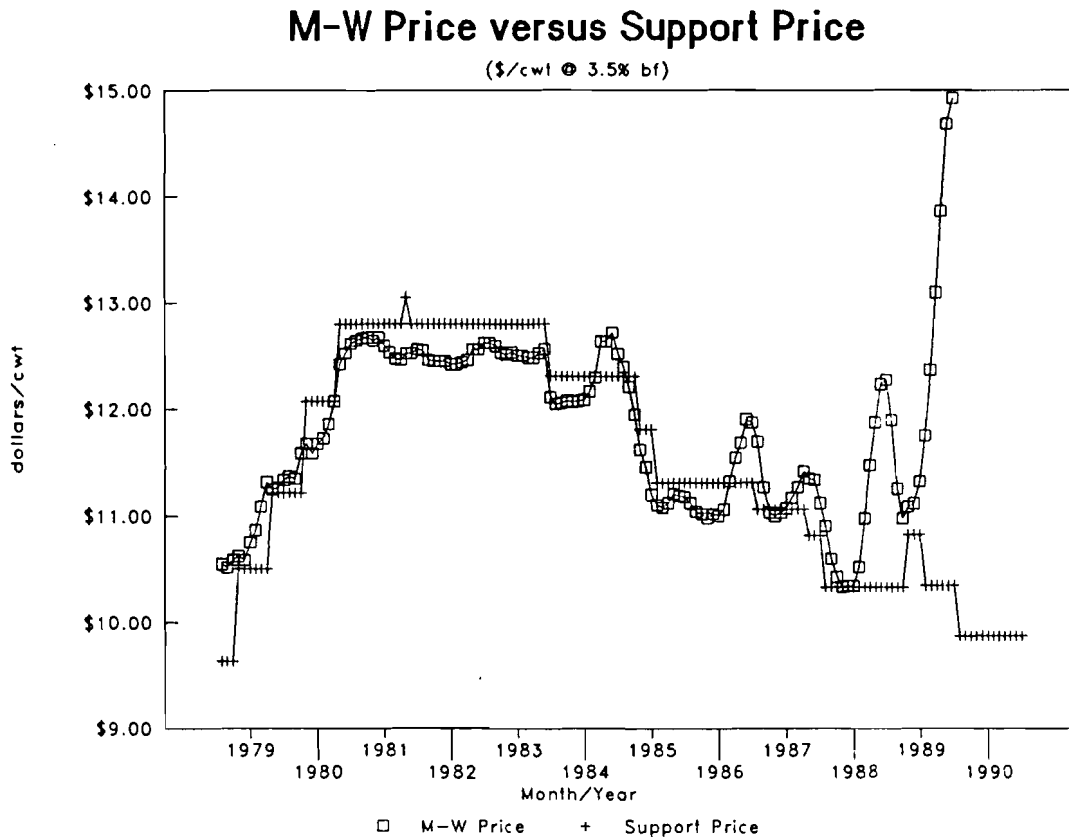
	1982	1983	1984	1985	1986	1987 ^a	1988 ^a	1989 ^b
Farm Milk (\$/cwt., ave. fat):								
All Milk	13.61	13.58	13.46	12.75	12.51	12.54	12.24	13.40
Grade A	13.80	13.75	13.61	12.90	12.62	12.66	12.34	13.50
Grade B	12.60	12.61	12.49	11.72	11.46	11.37	11.15	12.35
Milk Price:Concentrate Value	1.83	1.72	1.65	1.73	1.79	1.84	1.58	1.58
Assessment	.00	.48	.50	.125	.365	.188	.025	.00
Cheese (\$/lb.):								
CCC Purchase, Natural Cheddar, Grade A or higher, blocks	1.400	1.391	1.348	1.279	1.250	1.219	1.1525	1.166
Wholesale, Cheddar (40 pound blocks), National Cheese Exchange	1.358	1.352	1.341	1.248	1.260	1.213	1.210	1.350
Retail, Cheddar Cheese (1 lb.)	N.A.	N.A.	3.065	3.093	3.049	3.056	3.165	3.300
Butter (\$/lb.):								
CCC Purchase, Grade A or higher, Chicago	1.490	1.485	1.433	1.415	1.398	1.373	1.320	1.262
Wholesale, Grade A, Chicago (1 lb.)	1.477	1.473	1.488	1.411	1.445	1.402	1.325	1.276
Retail, Grade AA, sticks (1 lb.)	2.046	2.066	2.107	2.121	2.151	2.170	2.158	2.140
Nonfat Dry Milk (\$/lb.):								
CCC Purchase, Spray Process, Extra Grade, Unfortified	.940	.937	.910	.843	.808	.783	.728	.774
Wholesale (1 lb.)	.931	.932	.909	.841	.806	.793	.802	1.070
Retail Price Indices (1982-84=100.0):								
Whole Milk ^a	99.3	100.0	100.7	102.3	101.7	103.6	106.0	114.5
All Dairy Products	98.8	100.0	101.3	103.2	103.3	105.9	108.3	114.7
All Food	97.4	99.4	103.2	105.6	109.0	113.5	118.2	125.1
All Consumer Prices	96.5	99.6	103.9	107.6	109.6	113.6	118.3	124.2

Source: Dairy Situation and Outlook, Dairy Market News, and Federal Milk Order Market Summaries,
U.S. Department of Agriculture.

^a Revised.

^b Estimated by Andrew Novakovic from federal data for part of the year.

Figure 1.



the seeming anomaly with this declining trend, the CCC purchase price for butter is the only DPSP price that is providing any support to dairy markets presently, and this will basically be true for the rest of the year. With world market prices of 75¢ to 80¢ per pound, the CCC price may be holding U.S. market prices for butter some 30¢ above where they would fall in the absence of price supports. This equates to almost \$1.50 per cwt of milk value. Figure 2 compares the benchmark Chicago wholesale butter price to the CCC purchase price during the 1980s.

Wholesale prices for nonfat dry milk were exceptionally strong this year. Earlier in the year nonfat dry milk prices were buoyed by export market sales. Later in the year, nonfat dry milk prices reached unheard of levels largely due to extremely strong competition among domestic buyers who were struggling to find replacements for the shortfall of milk in their areas. At the end of 1989, NDM prices were falling rapidly as prior export commitments were postponed and current supplies were freed for domestic use. For the year, the benchmark wholesale price of nonfat dry milk is estimated to be about \$1.07 per pound, a third higher than the 1988 average. Hence, the DPSP isn't supporting NDM market prices currently. Market prices will continue to drop toward the CCC price and may reach it in Spring. CCC's price for NDM is about equal to the world price today. By this Spring, NDM processors may find that it is a toss-up between selling NDM on domestic markets, on world markets, or to the CCC. In either case, a CCC price at this level makes the CCC an alternative outlet, but it isn't doing much to support prices. Figure 3 compares the benchmark Central States wholesale price for NDM to the CCC purchase price during the 1980s.

Figure 2.

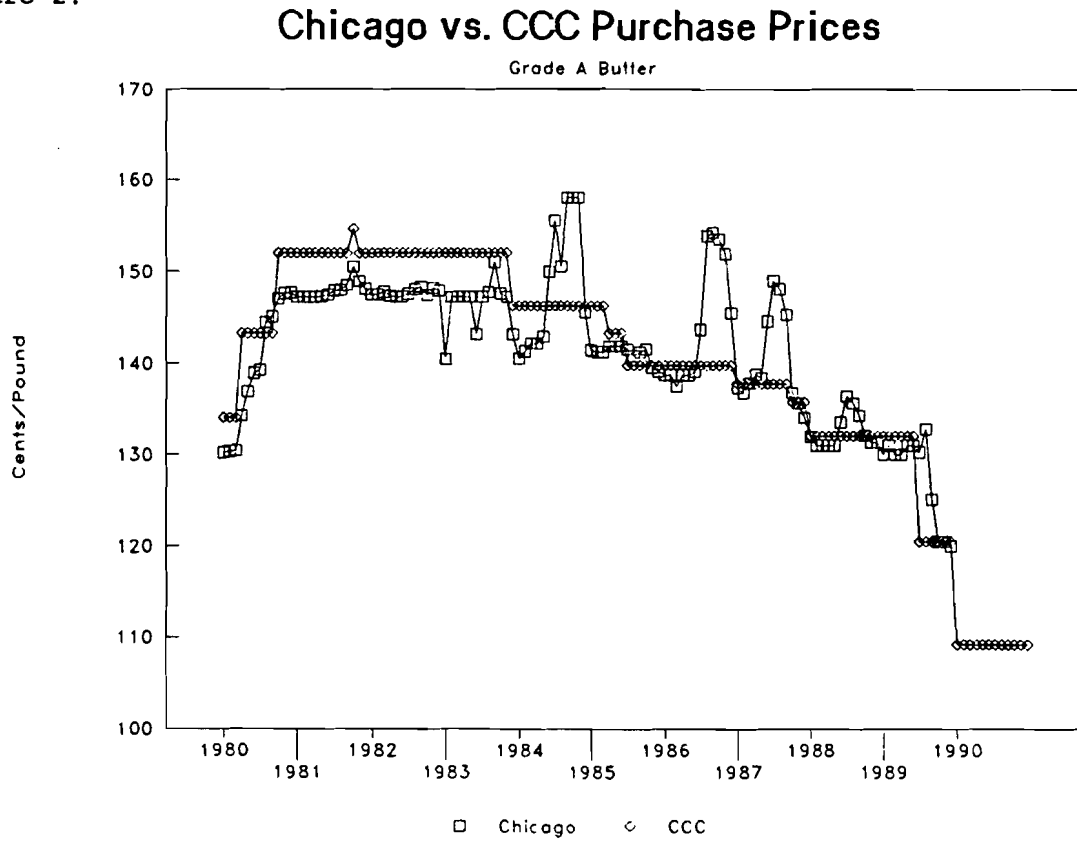
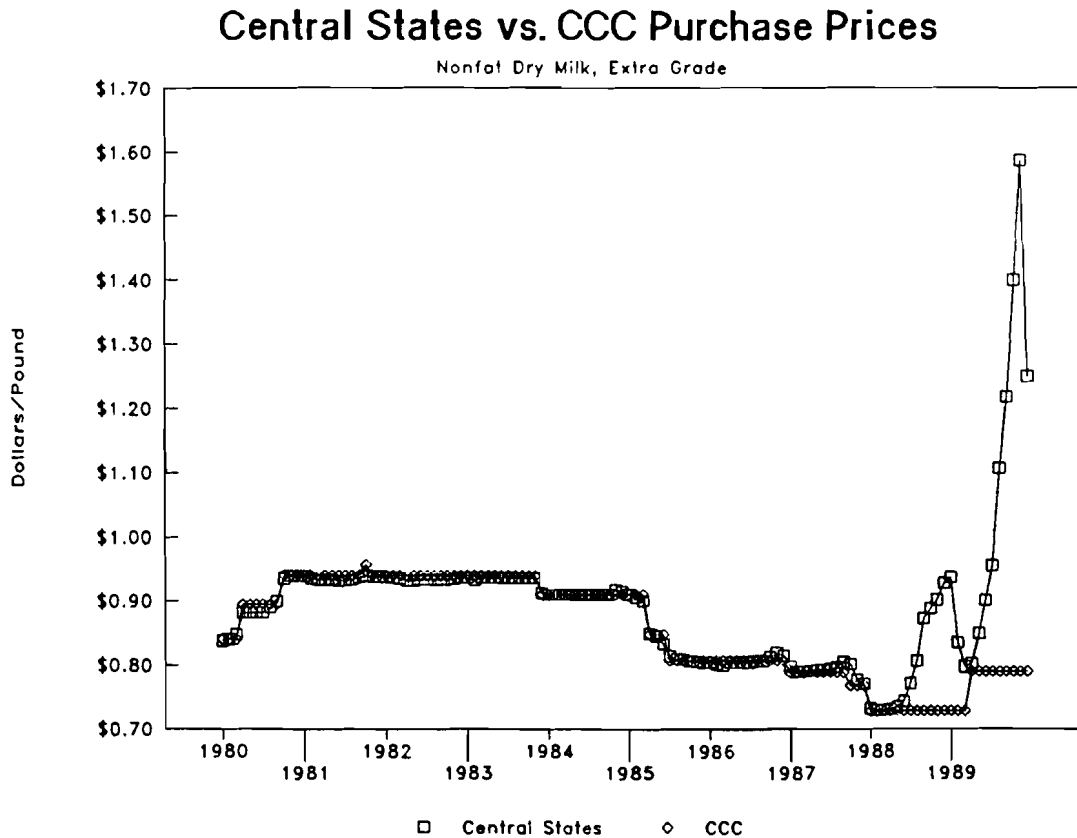


Figure 3.



Wholesale prices of cheddar cheese rose largely to keep pace with the nonfat dry milk sector, although good growth in cheese sales certainly contributed to the overall price strength. For the year, the benchmark wholesale price for cheddar cheese is estimated to be \$1.35 per pound, 12¢ higher than 1988 and 20¢ higher than the federal purchase price. Due to the stronger sales growth of cheese, cheese prices will not fall as close to support levels as prices for butter and NDM. In fact, cheese prices could be 10¢ to 20¢ per pound above the CCC purchase price. This equates to a \$1 to \$2 per cwt milk value. Thus, even if there are some limited cheese sales to the CCC, the CCC price for cheese isn't expected to add much support to cheese prices in 1990. Figure 4 compares the benchmark National Cheese Exchange price for 40-pound blocks of Cheddar to the CCC block purchase price during the 1980s.

The outlook for farm prices is shaped by current and expected wholesale prices. Numerous factors influence prices at all market levels. Disregarding short term fluctuations, prices at one level should be coordinated with prices at other levels. The relationship of farm prices to wholesale dairy commodity prices is illustrated in Figures 5 and 6. These figures try to reflect gross margins for cheese manufacturers (Figure 5) and butter/NDM processors (Figure 6). Specifically, they show the dollar/cwt of milk difference between the M-W price and yield adjusted benchmark prices for butter/NDM and cheddar cheese.

Figure 4.

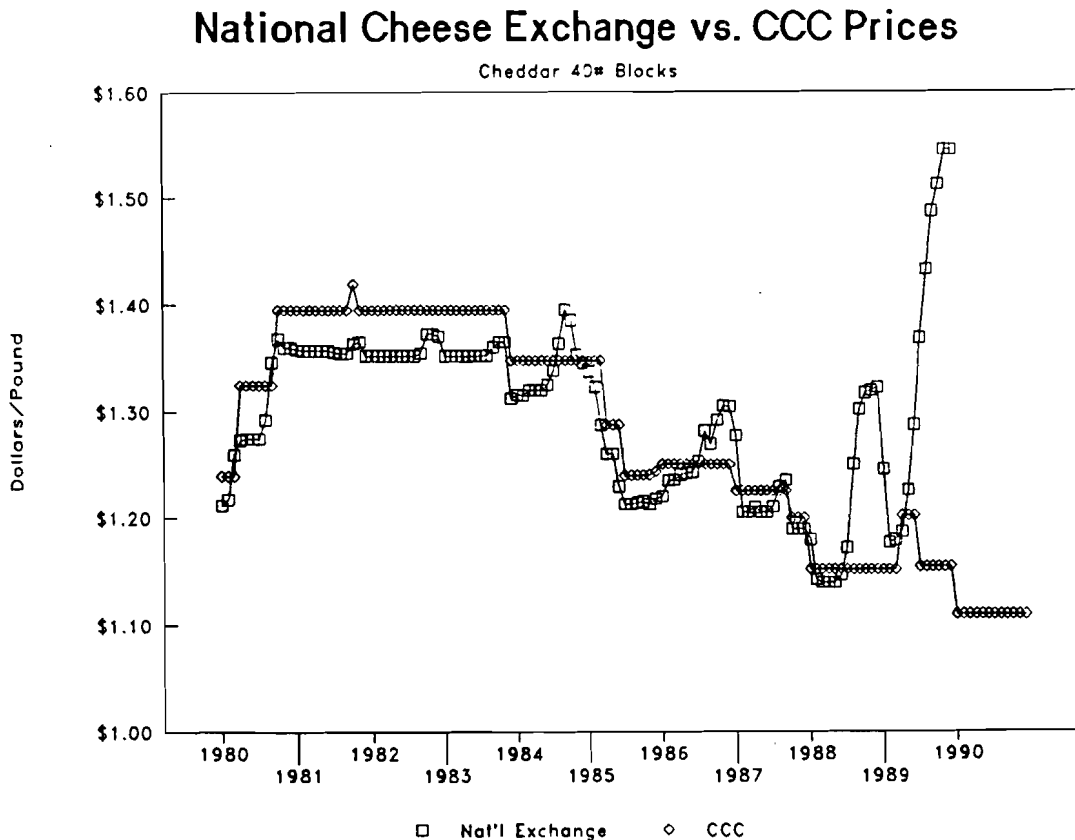


Figure 5.

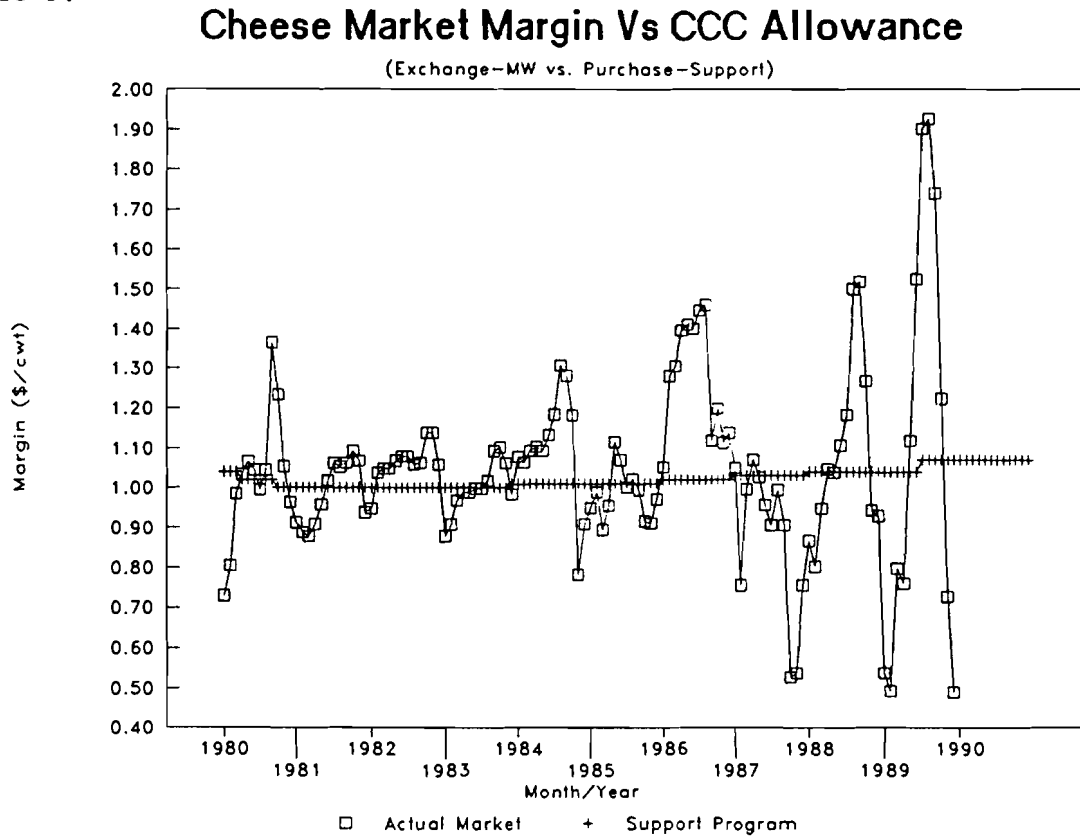
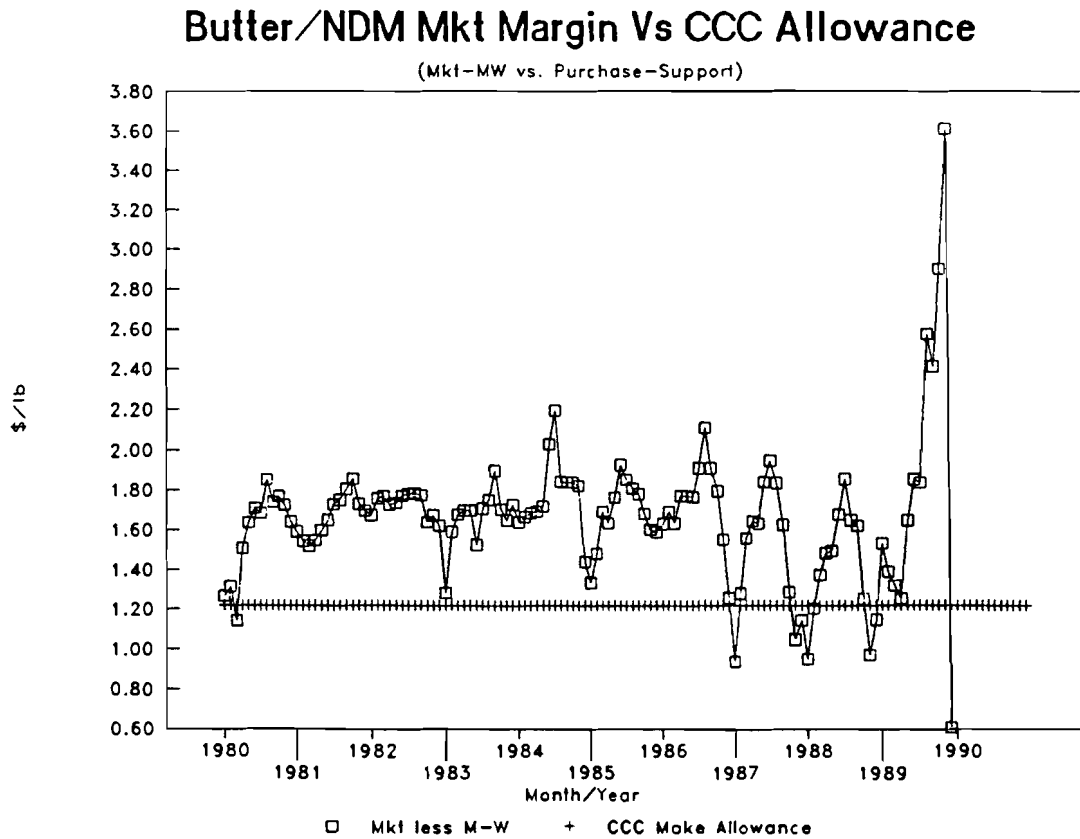


Figure 6.



These figures are rich with information. They indicate that 1) gross margins fluctuate considerably from month to month, 2) monthly fluctuations have become increasingly pronounced for cheese since the end of 1986, ranging from being well below processing costs to well above, 3) butter/NDM margins have fluctuated less until late 1989, and 4) in December 1989, the extremely high M-W has depressed gross margins in both commodity sectors to their lowest point of the decade.

With commodity prices already softening in early January 1990, it is obvious that the M-W price must come down. Butter prices will hang around the purchase price of \$1.0925 for most of the year. NDM prices will probably fluctuate between 80¢ and \$1 most of the year. Block Cheddar prices will probably bottom out between \$1.20 and \$1.30. At these prices, the M-W must move somewhere into the \$12 range before margins stabilize at a sustainable level. Tight milk supplies, especially in Wisconsin, will hold the M-W to the high side of this range. If milk supplies come back strongly, the M-W will likely drop into the \$11 range.

In past years, declines in farm milk prices have been reflected in lower wholesale prices for dairy products and retail prices that increased at less than half the rate of inflation for all consumer products. The nearly 10% average annual increase in farm prices has pushed retail prices to higher levels toward the end of 1989. All dairy product prices are estimated to average about a 6% increase over 1988. Whole milk prices may be up as much as 8% and cheese prices slightly more. Food price inflation should be about 5%, and the expected increase in the general Consumer Price Index is about 6%. Analysts will be watching dairy product markets, especially cheese, to see if the price increases that showed up in late 1989 affect sales gains in 1990. As farm prices fall, wholesale prices will fall too, just as they typically do. In fact, they are already falling, even though farm milk prices haven't started to fall yet. Hence, the critically important foodservice and food processing market for dairy products is not likely to see high dairy prices for long. Given the very large price swings that will occur at the farm and wholesale levels, it will be interesting to observe the response in retail prices over the next few months.

Policymaking Challenges for the 1990s

Although the word surplus has not been applicable to dairy markets since the summer of 1988, it would be a mistake to think that the problems of surpluses have been solved or that we need not factor the possibility of that event into our design for a new dairy title. There is a great underlying potential to increase milk production in the U.S. From the standpoint of long term food needs, this is exceedingly good news; for the time being it could present difficulties. In the past, not all regions, indeed not all farms, have contributed to increased production equally. It would be surprising if they did. The fact that they don't tells us about the differences in profitability of milk production in different parts of the country and across farms. These fundamental differences in profitability also have implications for how we draft federal dairy policy.

A recently released USDA study of costs of producing milk in 1987 estimates the pattern of returns illustrated in Table 3. Net cash returns per herd in the Northeast and the Wisconsin/Minnesota/Michigan/South Dakota area are below the national average and far below levels estimated for areas of the

country that have been experiencing considerable production growth. Differences in prices, cash expenses, herd size, and production per cow all contribute to the differences in net cash returns per herd. The most significant factor is herd size. This is not to suggest that increasing farm size is the only way, or even a sure way, to improve net farm income. Nevertheless, the USDA cost estimates speak plainly enough. The regions that have larger average farm sizes also have much greater total returns per farm.

A caveat about the USDA's Pacific region is in order. USDA puts California, Washington, and Idaho together in this region. The average herd size and production per cow reported for this grouping suggests that the USDA region is not typical or representative of any one of these states separately. The regional average herd size is much too small for California and too large for Washington or Idaho. Production per cow is too low for California and Washington and probably too high for Idaho. Consequently, the net return per herd estimate does not reflect well the range in herd sizes and other characteristics across states in the Pacific region. California net returns per herd would likely be much larger on average, at least using the USDA data. Net returns in Washington and Idaho would likely be lower.

What this means is that the traditional milk producing areas are much more vulnerable to price cuts. The following example oversimplifies how a price cut shows up in average cash returns because it assumes that farmers do not change their variable cash expenses when faced with lasting price shifts.

Table 3. Net Cash Returns to Farms in Different Regions of the U.S., 1987

Region	Cows/Herd	Pounds/Cow	Net Cash Returns ^a	
			\$/cwt	\$/herd
Northeast ^b	57	14,321	2.72	22,203
WI/MN/MI/SD	49	13,475	1.50	9,904
Florida/Georgia	388	12,217	3.20	151,686
Texas	128	13,055	3.40	56,815
CA/WA/ID	322	16,821	2.20	119,160
United States	108	14,029	2.02	30,606

Source: Dairy Situation and Outlook Report, USDA, February 1989.

^a Value of milk and cull cows less variable and fixed cash expenses

^b includes Ohio

Nevertheless it illustrates the point. Suppose that somehow the price of milk is reduced \$1 per cwt. across the country and that this shows up as a reduction of \$1 per cwt. in average net cash returns in each region. Net cash returns per herd are recalculated as shown in Table 4.

The total dollar reduction in the Southeast, say, is much more than the reduction for the Wisconsin/Minnesota/Michigan/South Dakota area, but under these simple assumptions the large Southeastern farm is still making a large sum of money and the small Upper Midwestern farm is barely breaking even on a cash basis. If the USDA cost calculations are anywhere near the mark, small wonder that producers on small to medium size farms are concerned about price cuts, and this applies no matter what region of the country the farm happens to be in. It must also be recognized that such fundamental differences cannot be mitigated by changes in a broad-based, national price policy.

If federal policy moves in any of these directions, the traditional milk producing areas in the Northeast and Upper Midwest will be in an increasingly challenging situation. It is overly simple to point to just one factor, but the biggest factor that will determine the future of the dairy industry in these areas will probably be the total income opportunities for farmers there compared to the parts of the country that have been expanding more rapidly.

Indeed, it is crucial to emphasize that this situation is not, per se, a regional one. Each region has its share of farm families who are doing quite well and those who are not doing well at all. What data exist on individual farms suggests that the differences between the haves and the have-nots is growing. Dairy policy has tried to steer a middle of the road course. This has always been hard to do. It will get harder and harder to do.

Table 4. Net Cash Returns Per Herd in Different Regions of the U.S. When Average Returns Are Reduced by \$1 per Cwt.

Region	Net Cash Returns, 1987		Net Cash Returns, with \$1 Cut
	\$/cwt	\$/herd	\$/herd
Northeast	2.72	22,203	14,040
WI/MN/MI/SD	1.50	9,904	3,301
Florida/Georgia	3.20	151,686	104,284
Texas	3.40	56,815	40,105
CA/WA/ID	2.20	119,160	64,996
United States	2.02	30,606	15,454

The Growing Importance of the Bigger Picture

Rural development, conservation of soil and water resources, environmentally friendly management practices, the globalization of dairy and other food markets, and other similarly large issues have impacted how we talk about dairy policy, and they have had some impact on policy choices. These factors and issues will become increasingly important. It would be prudent for the dairy industry and those who are concerned for it to begin thinking more seriously how the industry and policy needs to grow to deal with such issues.

Directions for Dairy Policy in the 1990 Farm Bill

Numerous proposals were discussed prior to passage of the last farm bill in 1985. All participants understand that the need for change is driven by high government costs associated with purchases of surplus dairy products under the price support program. Much progress has been made since (fiscal year) 1983, when net removals of dairy products equaled 16.6 billion pounds (m.e.) and net government expenditures peaked at \$2.6 billion. Today the surplus has been cut about in half and government expenditures have fallen by more than half. Yet, the problem is not solved.

Throughout the 1980s the focus of debates has been how to achieve these objectives, i.e. whether to treat dairy product surpluses with lower support prices or to use special production reducing incentives that are less financially hard on dairy farmers. Differences in the priority placed on the survival or prosperity of the greatest number of dairy farmers is probably the major reason for divergent proposals and points of view.

Total deregulation would immediately reduce government costs and purchases of surplus dairy products. Although this approach certainly has its adherents, most policymakers would agree that it is not desirable from the standpoint of other, longer term objectives. It is an unlikely option. Hence the relevant policy question is what program best addresses the endemic surplus problem without totally abandoning traditional long term objectives for farm income and market stability?

A survey of farmers in 21 states, taken last Spring and Summer, included a question asking them to indicate their preferences on alternative dairy programs. The composite response shows a plurality of all farmers favoring a phase out of dairy programs by about 2:1 over either keeping the present program or using production quotas and setting prices according to production costs. Not surprisingly, non-dairy farmers see less merit in dairy programs than dairy farmers do. When dairy farmers are singled out in the sample, a plurality indicate a 2:1 preference for the quota approach over either phasing out or keeping the present program. Among dairy farmers, the composite response indicates more would rather phase out the program than keep it. It appears that these dairy farmers are telling us they would rather have government programs do a lot more to support farm milk prices or do nothing at all.

Congress has tried some programs to "do more," i.e., voluntary supply controls. For many observers and analysts, the rapid rebound in milk production after the Milk Diversion Program (MDP) expired in March 1985 generally discredited supply control approaches. Its adherents argued that a few technical adjustments would improve the MDP; others argued that firmer approaches would work better. One could argue that the Dairy Termination Program (DTP), introduced in 1986, worked better than the MDP. The fact that production also resumed growing after the DTP phase-in period expired in September 1987, and speculation about some recidivism in 1991 (after the five year contracts expire) leave lingering doubts about the efficacy of the DTP. An even more important factor politically is the intense opposition to another DTP by the National Cattlemen's Association, who believe that beef prices did and would again suffer under the DTP. Consequently, there is little support in Congress for repeating the MDP and not much more support for another DTP. Although these supply control programs have not had the desired permanent effect on milk production, successive cuts in the support price have not appeared to solve the problem either. Thus, those who favor price cuts also

have had no strong evidence to support the efficacy of their approach. Recent events no doubt make it tempting to wonder if Congress couldn't just legislate drought or other acts of God every now and then.

The price of unity among producer groups in 1985 was a linkage of higher federal order class I differentials to supply controls. Hence, the House, largely with encouragement from producer groups, advocated a new MDP, a revised procedure for setting the support price that involved a sophisticated price formula, and regional increases in federal order class I differentials that were small in the North and larger in the South. The Senate, largely backed by processors and the Administration, favored legislation emphasizing price changes triggered by prospective levels of purchases of surplus dairy products. What emerged was a dairy title to the Food Security Act of 1985 (FSA) containing a whole herd buyout program, some assessments, triggered annual price changes starting one year after the bill was signed, and regional increases in class I differentials, as well as a number of lesser provisions.

Discussion about dairy for the 1990 farm bill is paralleling the debates in 1985 and 1983. Adjusting support prices according to anticipated net removals has gained acceptance among mainline dairy organizations, although all producers groups would like to see something in addition that would mitigate future cuts. Thus, there appears to be broad, albeit not enthusiastic, support for maintaining the triggered price change procedures that are the basic framework of the dairy title of the FSA.

The proposals of the National Commission on Dairy Policy and, more recently, the National Milk Producers Federation provide another important feature. They would add a requirement to use supply controls when modest price cuts prove inadequate and estimated surplus production exceeds a certain trigger level. While there is broad support among producers for some kind of standby supply management approach, there is widespread disagreement among producer organizations about the form it should take.

Alternatives to the price support program range from fine-tuning efforts to radical departures from the current program. Almost all of the options talked about today have been discussed many times since the inception of the current dairy price support program in 1949. Of the many options, almost all could be designed to improve the surplus problem or achieve some other objective. Some are less well-suited to specific tasks than others, but few can be dismissed out of hand as unworkable.

None of the basic approaches for supporting dairy farmers and markets is uniformly superior to another for an equivalent price or income effect. No plan offers an easy solution. Simple price reductions are the easiest administratively, but reasonable cuts take a while to have effect and do not accommodate benefit targeting, decoupling, or recoupling objectives. A new pricing standard isn't likely to work any better in the short run and may or may not be any better or less mischievous in the future than the current program. Production quota programs, new ways to administer support programs, and other such attempts to substantially change the dairy price support program may simply require a greater change than policymakers are willing to make, and even among farmers support for such major change is very uneven.

Federal Milk Marketing Orders and Dairy Import Quotas

In addition to proposed changes in the dairy price support program, federal milk marketing orders and dairy import quotas will probably receive considerably more discussion than they did during the last two farm bill debates. The FSA resulted in a noticeably larger difference between minimum class I and blend prices across milk marketing order areas from North to South. Midwesterners have argued strongly that they are unfairly penalized by federal order provisions that, they claim, unduly stimulate milk production outside of the Midwest and make it difficult to supply distant southern markets with Midwestern milk. This has inspired proposals to 1) reduce federal order prices in markets distant from the Midwest, 2) increase class I prices in the Midwest, and 3) require the USDA to alter federal order provisions which discriminate against the use of concentrated milk components (shipped from the Midwest) as an alternative to (local) farm milk. Northeastern and Southeastern producers generally believe that current federal provisions are reasonable and, if anything, class I differentials should be increased to more fully reflect interregional transportation costs.

Recent reports by the U.S. Government Accounting Office and, to a much lesser extent, the U.S. Department of Agriculture are critical of current federal order price structures and of the system itself. Other studies of so-called "mailbox prices" in Wisconsin and the South Central U.S. suggest that the regional prices actually received by farmers are much closer than is implied by a comparison of the minimum prices plants are required to pay under federal orders. In other words, non-order price premiums and marketing costs passed back to dairy farmers do much to shape regional price differences.

The 1990 farm bill may change the regional pattern of federal order prices. However, changes in minimum order prices can be offset by increases in over-order premiums. Thus, the net effect on farmers is not necessarily as large as a specific proposal may imply on the surface. Costs and benefits that might result from proposed changes have probably been overstated.

In my opinion, an overly simplistic understanding of FMMOs has resulted in overly simplistic analyses and prescriptions for changes. I think it would be unfortunate if Congress moved any further toward the micro-management of this complex program. Certain reforms and modifications deserve serious study and consideration. Things more complex than simple class I differentials need to be studied. I am not convinced that the work done to date provides a sufficient basis for making some of the large changes that have been proposed.

Dairy import quotas, which help the U.S. maintain domestic price supports, are becoming a topic of discussion because the U.S. is in the middle of the so-called Uruguay Round of multilateral trade negotiations under the General Agreement on Tariffs and Trade (GATT). As in earlier rounds, dairy quotas stand out as an exception to the philosophy and rules of the GATT.

Dairy import quotas will be staunchly defended by the U.S. dairy industry, which has successfully blunted forces for change in the past. Even the most ardent U.S. free-traders will not give up dairy product quotas without exacting major changes from other countries. The U.S. proposal calls for extensive changes in each country's domestic support policies as well as trade policies. Such changes will not come easily and may not be made at all; yet there is a strong desire on the part of all GATT participants to do something.

Summary Comment

It is not my role to advocate a particular program; I do not have a "special" interest. I do have a very strong general interest in the well-being of the industry that has been the purpose of my career. On this basis and after having watched several iterations of policy changes, I would venture these comments. In my opinion, it would be prudent to stick with the basic framework of the Food Security Act. Dairy markets are still recovering from the multiple shocks they weathered in 1989. It remains to be seen how they will settle out. It also remains to be seen how the GATT negotiations will play out; what kind of impact, if any, bovine growth hormone supplements will have; and how we will respond to some of the "bigger issues" mentioned earlier. Even if we wanted to adjust dairy programs to anticipate forthcoming changes, we hardly know what those changes will be. Nonetheless, these are real issues and they will have to be dealt with in the not too distant future. It seems extremely likely that, no matter what we do in 1990, we will have to revisit dairy policy again in the early 1990s as some of these scenarios play out. In the meantime, I would suggest we stick with what we have and know but prepare contingency options so as to be ready with appropriate actions when we understand better what we will need.

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