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6-1-1983

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Recommended Citation

Kelsey, Galen, "Dairy Price Support Program Dilemma" (1983). *Economics Commentator*. Paper 193.
http://openprairie.sdstate.edu/econ_comm/193

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No. 197

June 1, 1983



Dairy Price Support Program Dilemma

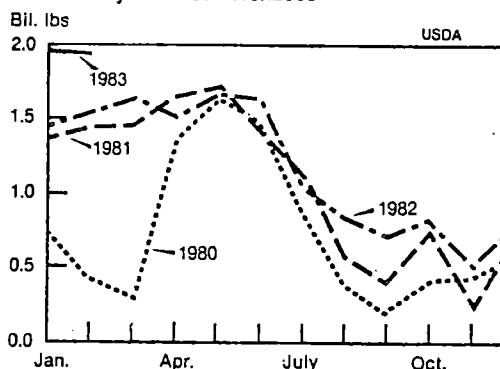
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The Agricultural Act of 1949 provided for the indirect support of the price of manufacturing milk at prices ranging from 75 to 90% of parity. The Act was amended in 1977, and again in 1979, to establish a minimum support price of 80% of parity through September of 1981. Prices are indirectly supported by the Commodity Credit Corporation (CCC) through the purchase of carload lots of butter, cheese and non-fat dry milk.

As a result of higher prices for manufacturing milk, USDA net market purchases rose from less than 1% of total production in 1978-79 to 6.4% in '79-'80 and 9.6% in '80-'81. Purchases in 1982 have continued the upward climb to about 10.5% of milk production, and will continue to increase in 1983 if no change is made in the program. We are producing nearly 15% more milk annually than we can consume. Since 1975 there has been a corresponding increase in program costs, with the present annual cost estimated to be 2.5 billion dollars.

In spite of increased donations to the school lunch program, cheese "give-away" programs, and increased foreign and domestic sales, government stocks have grown. This is because of increases both in dairy cow numbers and production per cow. As of May 6, 1983 CCC has in storage 456 million lbs of butter (up 15% from a year earlier), 778 million lbs of cheese (up 24%) and 1.2 billion lbs. of non-fat dry milk (up 22%).

USDA Dairy Product Purchases*



*Net removals, milk-equivalent, fat-solids basis. Neg. ERS 8449-83(3)

1982 Legislation

The Omnibus Budget Reconciliation Act of 1982 contains features designed to reduce the cost of the dairy price support program. Under this law the minimum level of support for the marketing years 1982 and 1983 is set at \$13.10 per cwt for Grade A milk used in manufacturing. For 1984 the minimum support level will be the level of parity represented by \$13.10 on October 1, 1983.

Another feature of the Act authorizes the Secretary of Agriculture to deduct 50 cents per cwt from dairy farmers' receipts if the net price support purchases for the marketing year exceed 5 billion pounds of milk equivalent. The Act authorizes a second 50 cent assessment on or after April 1, 1983 (until Sept. 30, 1985) if net support purchases exceed 7.5 billion pounds of milk equivalent.

Secretary Block attempted to implement the first 50 cent assessment in December 1982 and again on April 16. Both attempts were blocked by court action brought about by dairy groups on the grounds that proper procedures were not followed in the implementation process. The way has now been cleared, however, for the first assessment to be levied.

Why all the fuss over a 50 cent assessment? Depending upon the local milk price, which varies from one area of the country to another and fluctuates from week to week within any given area, the 50 cent deduction amounts to about a 4% reduction in milk price. While this may appear to be a minor loss, it represents (according to John Maher, Area Extension Farm Management Specialist) a drop in net dairy income for the Class III milk producer of about 9 to 11%, depending upon the size of the capital investment.

If the second 50 cent assessment is put into effect, the net income of the South Dakota dairy producer would be reduced somewhere in a range between 17 and 22%.

Faced with these kind of losses, there is speculation that many producers, in an attempt to keep their income at present levels, will increase their production. If they do, the surplus dairy products problem will be further aggravated, rather than alleviated as intended in the legislation.

Alternatives Being Considered

Secretary Block, when announcing the imposition of the first 50 cent assessment, said he would delay implementing the second Congressionally-authorized 50 cent assessment until August 1 to give Congress time to adopt more effective legislation. The assessment program is viewed by everyone as a stop-gap measure to be used until something more permanent can be hammered out.

Several proposals for a major overhaul of the program are under consideration. They include a two-price system, a quota system, a price incentive program, a reduction in the level of price supports, and a possible expansion of dairy product exports. None of these proposals is totally new.

The **two-price system** is not unlike the present program. While the mechanics of the program may differ among proponents, the basics are the same. The Commodity Credit Corporation would continue to support a high milk price through market purchases. But unlike in

the present program, products purchased over needs for school lunch and welfare would be sold abroad at world prices. Losses incurred from foreign sales would be pro-rated back to the dairy producers in the form of an assessment based upon the ratios of total product sold in the domestic market versus in the world market. The end price to the producer would be a blend between the domestic and world prices.

Critics of the proposal oppose it for at least two reasons. The U.S. has a comparative advantage in the production of many agricultural products. We have been long-time proponents of free trade in the world market place and have been critical of nations that practice protectionism and subsidized sales, such as the European Common Market. Such a program for dairy would weaken our bargaining position on other agricultural export policy agreements.

The second argument is that the recipient of the "bargain basement" sales of dairy products would most likely be the Communist Bloc nations. Dairy producers in the rest of the world would not welcome our imports anymore than our Ag producers welcome imports, whether they be cheese, meat, grains or wool. Such a program could set off a trade war among food exporting countries.

The **quota system** proposal is quite similar to the present tobacco price support program. Producers would be assigned a base equal to milk production in some recent period. A quota would be calculated from this base so as to assure that if only quota milk were produced all would sell in the domestic market. If a producer sold more than the quota, he would receive only the world price for over-quota milk. Because of the disincentive to produce more than the quota, the problem of surpluses and subsidized sales on the world market would be alleviated.

One problem with a quota system is that program benefits soon become capitalized into the value of the quotas. Our experience with the tobacco program testifies to this fact. Quotas assigned to tobacco farmers nearly 50 years ago have been passed on to their heirs, who

no longer raise tobacco but lease their quota to tobacco growers. The General Accounting Office recently estimated that only about 26% of the present growers produce tobacco on their own quotas. The other 74% must lease quotas from non-growers, with the result that many of the program benefits are reaped by non-farmers.

Just as with the tobacco program, a fledgling farmer would have little opportunity to enter into dairy, and recent entrants into dairy might not be assigned a base if they were not producing during the base period. This could very well spell bankruptcy for many such producers.

The **price incentive program**, favored by the National Milk Producer Federation, is a variation of the quota system. Under this scheme the government would pay \$10 per cwt by which dairymen cut their production from 1983 production levels, up to 30%. In effect, the 1983 production level would be the quota in future years.

The same problems with the previously mentioned quota system would apply to this program, except there would not be any barrier to new producers who could sell at the support price. There might also be the familiar "free rider" problem. Producers who chose not to go into the program could maintain, or even increase their production to any level and still receive the support price.

Another possibility is **a cut in the present price support level**. The American Farm Bureau has proposed lowering the present minimum to as low as \$11.32 per cwt. Spokesmen for USDA have indicated the agency would support a one dollar cut.

A \$1 cut in price support level and a \$1 assessment may appear to be the same thing. The effects on consumers and taxpayers, however, would likely be quite different even though Class III dairy producers' incomes would be reduced about the same in either case.

If the price support level is reduced by one dollar, presumably the consumer would pay about 7.5% less for

milk and the storage cost to government would be reduced by about 7.5%. If a one dollar assessment is imposed, the consumer would pay about the same market price for milk. The Federal Government would receive the assessment revenue, which would be used to help pay the cost of the program.

A fifth alternative is to try to increase **export possibilities**. The European Economic Community (Common Market countries), which heavily subsidizes agricultural product exports, is having surplus dairy product problems too. In spite of increased subsidy levels, their butter and non-fat dry milk stocks are even greater than ours.

U.S. dairy products are difficult to market through international trade channels because of differing market grades and packaging standards. Most of our surplus butter is packaged in 64-68 lb boxes. It is also a salted product of 80% butterfat content. International butter market standards are based on an unsalted 82% butterfat product packaged in 250 or 500 gram packages.

Nearly all of our CCC inventory of non-fat dry milk is unfortified and of questionable use for anything other than recombination or animal feed.

About 60% of CCC stocks of cheese is held in 500 lb barrels which, before consumption, must be broken down into consumer sized processed cheese loaves. Another 30% of the stocks in storage is in 40-60 lb blocks of cheddar, which again is unsuitable for the international market.

The only market for our cheddar cheese is in those countries that are former members of the British Commonwealth, many of which have surplus dairy product problems too. People of the rest of the world do not eat cheddar.

Even if we changed our product standards to meet world market standards, we could not profitably reduce our dairy product surpluses. World market prices are too low. To significantly increase our market share, would require large subsidies of export sales at taxpayer expense.

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Conclusion

It is quite evident that our dairy surplus problem will not just "go away". We cannot continue indefinitely to pile up stocks of these highly perishable food products which are costly to store.

Dairy industry officials have objected to recent "give-away" programs on the grounds that they have affected commercial sales.

At the present, dairy producer groups have taken different views on possible solutions to the problem. It is becoming quite evident, however, that a consensus must be reached soon or Congress will have the unhappy task of choosing an alternative to the present program themselves. The result may not be particularly pleasing to any of the dairy producer groups.