Agricultural Economics
Staff Paper No. 86-15
January 1986

THE DAIRY TITLE OF THE FOOD SECURITY ACT OF 1985*

By

Larry G. Hamm
Department of Agricultural Economics
Michigan State University

On December 23, 1985, President Reagan signed the Food Security Act of 1985. The first title of this new comprehensive five-year Farm Bill establishes the national dairy policy through the end of 1990. The Act requires the Secretary of Agriculture to conduct an 18-month whole herd buy-out program; continues the current price support system, but mandates price support cuts; makes important changes in the federal milk marketing order system; and provides for several special studies and new programs. The 1985 Dairy Bill does not remove all the uncertainty from the market. It does, however, establish conditions whereby most dairy producers will have to make some long-term decisions.

The Milk Production Termination Program

The Act requires the Secretary of Agriculture to establish a voluntary Milk Production Termination Program (MPTP) to remove resources used to produce 12 billion pounds of milk during the 18-month period being April 1, 1986 and ending September 30, 1987. Under the MPTP, producers will voluntarily submit a bid to the Secretary for the milk produced by the producer during some yet to be prescribed marketing period. In return for a payment from the Secretary, the producer must: (1) sell for slaughter or export all the dairy cattle in which the producer has an interest; (2) not acquire any

---

*This paper was prepared for publication in the January 18, 1986 issue of Michigan Farmer.

interest in dairy cattle or in the production of milk; and (3) not acquire or make available to any one else any milk production capacity of the producer's facility that is freed up because of the MPTP. These three restrictions will remain in effect for a period of three, four, or five years, depending on how the Secretary specifies the contract.

Details Left to the Secretary of Agriculture

The Congress gave the Secretary almost complete authority to specify the details of the MPTP. Most of the rules will not be known until early February. However, most analysts believe the Secretary will operate the program in the following way. He will establish a marketing period of one year. The producer will be asked to submit a bid in the form of a per cwt. price for the production during that one year base period. Presumably, the Secretary will accept the lowest bids first in order to keep the Program's costs as low as possible. Since the Bill requires the Secretary to take out 12 billion pounds of capacity, the Secretary must accept all reasonable bids until he has reached that level. Therefore, a producer's bid determines not only how large his payment will be, but whether he gets accepted into the MPTP.

For example, if the Secretary sets 1985 as the base year and the producer marketed 1,000,000 pounds of milk, than his bid would be multiplied by 10,000 cwt. Suppose the dairyman bids $1 per cwt. and the Secretary accepts his bid, the producer would receive a payment of $10,000. The producer would aslo generate revenue from the sale of his cull cattle. Irrespective of how long the contract runs (three, four, or five years), the producer receives only the $10,000 for one year's milk production. However, the MPTP details may permit the producer to receive his $10,000 in installments over several years.

Other details like: (1) which month during the 18-month program will individual bids be executed?; (2) how will participants in the diversion program have their marketing history adjusted?; (3) what are dairy facilities?; (4) how are dairy cattle defined?; (5) etc.? -- are all yet to be determined. The USDA's Agricultural Stabilization and Conservation Service (ASCS) will operate the program and most likely the local

ASCS offices will be charged with implementing the bidding and enforcement processes. The ASCS will be developing the specific details of the program through January and early February. Until then, producers will have to wait to make detailed calculations about the bid levels.

MPTP Funded By Remaining Producers

The payments made to successful bidders in the MPTP will come primarily from a reduction in prices received by all producers marketing milk during the program. The Act sets the first price reduction to be 40 cents per cwt. for the period April 1, 1986 to December 31, 1986. From January 1, 1987 to September 30, 1987, the price reduction will be 25 cents per cwt. It is anticipated that these reduced producer prices will generate a pool of money almost large enough to cover the payments to successful bidders. However, until the program bids are accepted, the total cost of the MPTP will not be known. If costs exceed the pool generated from dairy farmers, the government will make up the difference with monies saved because the MPTP will have reduced CCC surplus purchases.

Producers Required to Furnish Records

The Act requires that any producer making a bid must provide the Secretary with three basic sets of records. The first is the dairyman's production in the marketing period. Except for transfers between direct family members, no one beginning milk production since January 1, 1985 will be eligible for the MPTP.

The second set of records required will be the size and composition of the producer's dairy herd during the marketing period.

The final records required will be the size and composition of the producer's herd at the time the bid is submitted. Significant differences between herd size and composition might prejudice the Secretary against a producer's bid. Producers contemplating bidding in the MPTP are well advised not to make significant changes in their herds between now and the bid acceptance period.

The Act also provides for substantial financial penalties for violating the contract or for knowlingly providing false records. Penalties are included for anyone who buys and puts into production animals destined for slaughter or export because of the MPTP.

Other Livestock Industries to be Considered

The Act requires the Secretary to take into account the possible adverse effects the MPTP can have on U.S. beef, pork, and poultry producers when he establishes the terms and conditions of the program. The Act explicitly provides two forms of protection for the red meat (beef, pork, and lamb) industries. First, the Secretary is required during the 18-month MPTP to buy 400 million pounds of red meat in addition to normal purchases for the commercial market. Two hundred million pounds each are to be distributed through domestic commodity and nutrition programs and through export programs or foreign military installations. Second, the Secretary is directed to make sure that more dairy animals are slaughtered in the periods April through August 1986 and March through August 1987 than in the period September 1986 through February 1987. The fall-winter period is historically when beef cow marketing is greatest.

Price Support $11.60 for 1986 then Cut 50 Cents in 1987

The Act maintains the basic price support system first established by the Agriculture Act of 1949. Since the old Farm Bill expired September 30, 1985, the dairy price support has been extended several times at the $11.60 (for 3.67% milk) level. The new Act freezes the $11.60 level through calendar year 1986. On January 1, 1987, the support price drops 25 cents per cwt. (to $11.35). A second 25 cent drop takes place on October 1, 1987 (to $11.10).

The purpose of the MPTP is to dramatically reduce production so that future government CCC purchases under the price support program would be at an acceptable level. Should the nonparticipants in the MPTP increase production dramatically during the 1986-87 period, the new Dairy Title calls for dramatic price support cuts in calendar years 1988, 1989, and 1990.

If the Secretary determines on January 1 of 1988, 1989, and 1990 that the anticipated CCC surplus purchase for the coming calendar year will exceed 5 billion pounds (milk equivalent), he shall reduce the price support by 50 cents per cwt. If dairy surplus should continue and the Secretary does not invoke another buy-out or diversion (see below), the dairy price support could drop to $9.60 in 1990.

Conversely, if the MPTP is very successful and nonparticipants do not increase production, the price could be raised 50 cents per cwt. in each year 1988, 1989, and 1990. If the Secretary determines that surplus purchases are anticipated to be less than 2.5 billion pounds (milk equivalent) on January 1, he shall raise the price support by 50 cents per cwt.

Table 1 summarizes the price consequences of the 1985 Dairy Title. Although the price support is frozen for 1986, the MPTP price reduction of 40 cents per cwt. will lower producer revenue in 1986. As the MPTP assessment drops to 15 cents on January 1, 1987, the price support drops 25 cents and when the MPTP price reduction ends, the second 1987 price support cut of 25 cents per cwt. takes effect.

Future Price Support Cuts Uncertain

Successful operation of the MPTP could very likely lift farm prices above the support price. Price support cuts only move the Minnesota-Wisconsin (M-W) price lower when there are large surpluses. If the MPTP eliminates surplus production, especially in the Wisconsin and Minnesota area, the M-W price could rise and the price support would no longer be the floor of the market. Recall, this happened in the fall of 1984 during the operation of the 1984-85 diversion program. This situation of spot shortages of milk could happen as early as the fall of 1986, but is more likely by fall of 1987. Whether farm prices will rise will depend on how much more milk is produced by dairymen outside the whole herd reduction program.

Another condition could lead to no price support cuts in the 1988-90 period. The Congress passed a Bill which gives the Secretary of Agriculture most of the power to

design an effective MPTP and also gives him the power to cut price supports $1.50 per cwt. if the MPTP does not sufficiently reduce surpluses. To assure that the Secretary designes an effective MPTP, Congress added a provision that could potentially veto any price support decreases in 1988 through 1990. The Act requires the Secretary to take all reasonable bids from producers so that participants in the MPTP reduce production at least 12 billion pounds during the 18-month period. If a 12 billion pound reduction is not achieved, the Secretary must prove to Congress that reasonable contract offers were extended, but were not accepted by enough producers to meet the 12 billion pound goal before he would be allowed to lower price supports on January 1, 1988 through 1990.

Therefore, for those producers not participating in the MPTP, the milk price outlook is clouded. Their 1986 milk price will be lower because of the direct deduction from their checks to partially pay for the MPTP. However, future price support cuts are not certain and, if they were, the market prices might be above the support levels.

Federal Milk Market Order Changes

The Act raises the Class I milk price differentials for 35 of the current 44 Federal Milk Orders. The increased differentials are mandated for two years and then would have to be renewed by the administrative hearing process. These differentials are added to the M-W price to determine the Class I price in each Federal Order. If cooperative over-order pricing remains unchanged, the higher differentials will result in higher producer uniform or blend prices. For those Federal Orders directly affecting Michigan, the Class I differentials are as follows: Southern Michigan Order 40, $1.75 (up 15 cents); Upper Peninsula Order 44, $1.35 (no change); Ohio Valley Order 33, $2.04 (up 34 cents); Indiana Order 49, $2.00 (up 47 cents); and Chicago Regional Order 30, $1.40 (up 14 cents).

A second change dealing with Federal Orders in the Act is an amendment to the Agricultural Marketing Agreement Act of 1937. The amendment would allow qualified cooperative associations and handlers to be reimbursed for the marketwide services they perform from the market order pool before it is distributed via the uniform price.

Changes to any Order to allow marketwide service payments would be made through the normal hearing processes.

The two changes to the Federal Milk Market Orders may become the most controversial aspects of the 1985 Act in years to come. For the next three months, however, everyone associated with the dairy industry will be concentrating on the MPTP.

Miscellaneous Provisions of the Act

The Dairy Title of the 1985 Act also has several miscellaneous provisions and programs. The Act addresses casein problems in two ways. It requires a study of the impacts of imported casein on the price support system and also provides a program to help develop a domestic casein industry. The Act establishes a National Commission on Dairy Policy to investigate the impacts of emerging technology on the price support system. It also authorizes the establishment of a National Dairy Research Endowment Institute to foster basic dairy product development. The Endowment funding would not come from producer assessments. The Act eliminates the whey credit for cheese price support calculations established by Secretary Block on April 1, 1985. Finally, the Act establishes a Dairy Export Incentive Program via a dairy export PIK.

Uncertainty to Continue

The Dairy Title of the Food Security Act of 1985 goes a long way in eliminating some of the price and program uncertainty overhanging the industry. However, it creates new elements of uncertainty.

The dairy diversion program was criticized because it attempted to limit surplus by retiring only one basic element of dairy production--dairy animals. The MPTP will attempt to remove 12 billion pounds of production capacity by idling animal, physical, and human investments, i.e., people, facilities, and cows. The decision to participate in the 1984-85 diversion program was complicated, but producers still were milking cows and using their dairy investments. The decision to completely leave the industry temporarily and perhaps permanently is a much more complex and difficult decision.

Unfortunately, producers cannot make detailed financial calculations until the Secretary writes and distributes the rules governing the milk production termination program. Until then, the uncertainty continues.

If the MPTP works, the overall dairy industry supply-demand balance might be restored and the majority remaining in the dairy business may face a future with market prices and without continual potential for lower price supports. However, if the MPTP does not work and/or nonparticipants increase production dramatically, future prices could be dramatically lower. Until we know, the uncertainty continues.

The Act permits the Secretary to implement a milk diversion or MPTP in any of the years 1988, 1989, or 1990 if he determines that these are still burdensome excess supplies of milk and milk products. Therefore, the future may hold another diversion program or another MPTP. The possibility of further supply adjustment programs means the uncertainty will continue.

One reason milk production increased in the face of lower milk price supports ($1.50 in the last two years) was because feed prices fell and income for most other farming ventures declined. The Dairy Title of the 1985 Act, when analyzed by itself, appears to have the potential to reduce milk surpluses. However, the Act also affects all other commodities. Will the lower grain prices being predicted because of the Act spur milk production further? The cross-currents set up by the Act could produce unforeseen market consequences. The uncertainty continues.

Finally, at the news conference held after the Act's signature, the Secretary implied that he would attempt to change some of the Act's titles that the Administration does not like (dairy, sugar, rice, honey, etc.). With the passage of the Gramm/Rudman Act, the Administration may attempt to lower dairy price supports (because of federal budget deficit considerations) this year. Also, the budget deficit battles may cause Congress to pass another Farm Bill after the 1988 election. The uncertainty continues.

The 1985 Act may prove to be a milestone for the dairy industry. The MPTP appears to be a unique program which could help many dairymen leave the industry. For the vast majority who stay, the Act may require that they make a renewed dedication to their dairy enterprises and a long-term commitment to meet the uncertain future head-on.

Table 1. 1985 Dairy Bill Pricing Calendar

Calendar Date	1/1/86	4/1/86	1/1/87	10/1/87	1/1/88	1/1/89	1/1/90
Support Price ($/cwt.)	$11.60	$11.60	$11.35	$11.10	(± 50 cents based on CCC purchase levels)		
MPTP Price Reduction ($/cwt.)		.40	.25	.00	.00	.00	.00