Working Paper WP96-4 November 1996

Fifth Joint Conference on

Agriculture, Food and the Environment

Proceedings of a Conference Sponsored by
University of Minnesota
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Universita degli Studi di Padova
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SESSION I: RECENT TRENDS IN AGRICULTURAL POLICY OF THE USA AND EU

PAPER 2: U.S. GOVERNMENT INTERVENTION IN DAIRY MARKETS: HAS THE 1996 AGRICULTURAL ACT REFORMED THE GOVERNMENT'S ROLE?

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Abano Terme - Padova, Italy
June 17-18, 1996

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U.S. GOVERNMENT INTERVENTION IN DAIRY MARKETS: HAS THE 1996 ARGRICULTURAL ACT REFORMED THE GOVERNMENT'S ROLE?

by

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Paper presented at Fifth Joint Conference on Agriculture, Food
and the Environment, June 17-18, 1996
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Introduction

The dairy provisions of the Federal Agricultural Improvements and Reform Act (FAIR) of 1996, as with other commodity programs of the Act, have been heralded as reform, deregulation and a major movement away from government involvement in this sector of U.S. agriculture. A cursory review of the dairy provisions indicates that government involvement in the sector is far from being terminated and some new 'wrinkles' have been added. Thus, what changes does this legislation really make in U.S. dairy programs. It's my view that no fundamental reversal has been made in U.S. dairy pricing programs, to the contrary, we could be moving toward an industry with more regulation, and regulation that has more regionally divisive programs than we have had in the past.

My objectives today are: (1) to describe basic characteristics of U.S. dairy price programs prior to 1996, and (2) to provide you with my assessment of how the changes in the FAIR of 1996 will change our government's involvement in the sector.

Pre-1996 Dairy Price Programs

No U.S. agricultural sector has had more programs to regulate the prices than the dairy sector. The programs include: federal price supports, federal milk marketing orders, state milk marketing controls, and import and export programs. Let me review the development and some of the general features of these programs.

Price Support

Support for U.S. milk prices was first authorized by the agricultural legislation of the 1930's, but was not mandated.[1] The federal government purchased dairy products, butter, cheese, dried milk, and evaporated milk to provide limited support to the market. These acquisitions were used largely in domestic food assistance and feeding programs. Specified levels of support for milk used in manufactured dairy products were not provided until a special temporary wartime program of the early 1940's tied support to a 'parity' price, a formula price indexed to prices paid by farmers. Markets were strong during WWII, but, by the late 1940's, prices had fallen to support price, and government intervention was needed to achieve the minimum prices. Support was achieved by government purchases of butter, nonfat dry milk and cheese from plants at prices that permitted plants to pay the support price.

Until the late 1980's, product removals to maintain the support were required in almost every year since the late 1940's, with the milk equivalent of removals frequently between 4 and 7 percent of national milk production. Until 1980, the parity driven level of support did not cause serious problems, either in terms of government costs or government purchases of

[1] A brief period of price stabilization for dairy and other agricultural products was carried out with marketing loans by government to processors under the Agricultural Marketing Act of 1929.

products, but that changed in 1979-80. Extremely high levels, more than 12 percent of production, led to removal of parity as the determinant of the level of support in 1981. A mandatory producer assessment to expand generic promotion and producer assessments to cover some of the costs of price support were initiated in the early 1980's. Still milk production expanded more rapidly than commercial demand and government costs continued high. An expanding federal budget deficit increased the pressure on all government programs that required government outlays. A dairy diversion program in 1984 and 1985 and the dairy termination program in 1986 and 1987 with continued reductions in the support price (usually tied to projected surplus removals) began to bring commercial demand and supply into balance. By 1989, intervention buying ceased being the cornerstone of U.S. dairy price support policy. Figure 1 illustrates this characteristic of the U.S. manufacturing milk market. Prior to 1989, the support price, essentially determined the market milk price for milk used in manufactured dairy products. Since then, market prices have moved off support and have been on support only for a brief period in 1991. The nominal support price was reduced 23 percent from its high in 1981 to 1996. Purchases for support have declined to negligible levels.

Federal Orders

Federal Milk Marketing Orders have been a key component of federal dairy pricing programs since the 1930's. These regulations effectively establish 'marketing boards' to apply price discrimination to the sale of milk to processors. These regulations have been applied to specified milk markets, usually identified by the area of competition for beverage milk sales.

Currently, there are 33 of these regulations fixing prices for about 75 percent of all milk produced in the U.S. The currently regulated areas are shown if Figure 2.

Class prices for milk are established according to use of the milk with prices for milk used in beverage use and soft manufactured products established at fixed differentials above the average national manufacturing milk price in non-federal order markets. This manufacturing base price is the mover of class prices for all markets. Fluid use milk is priced at differentials above this manufacturing price and differ for each of the market areas, ranging from $1.20/cwt. to more than $4.00/cwt. Fluid use prices generally increase with distance from northwestern Wisconsin, i.e. a single basing point pricing. Price differentials for milk used in soft dairy products are the same in all markets at $.50/cwt. The price for milk used in manufactured dairy products is the non-regulated manufacturing milk price (with some markets having a separate class for milk used in production of dry milk). The rationale for the single manufacturing milk price is that the market for these products is national and, thus, the prices should be consistent and competitive with the national market prices.

Producers in each federal order market receive a blend price determined by the individual market's class prices and its utilization of milk in the various uses. Obviously, this provides the highest blend prices for producers in markets with the highest class prices and the greatest utilization of milk in fluid products. For example, the November 1995 blend price in the Upper Midwest Market with 23.5 percent fluid utilization was $12.95/cwt. while the Southeastern Florida Market with fluid utilization of 93.2 percent had a blend price of $15.92/cwt.

The revenue enhancing potential of price discrimination in fluid milk markets has long been attractive to producers in fluid milk markets. The more localized character of the fluid market always assures that demand confronting that markets producers in this market segment is much more inelastic than that of the national manufacturing milk market. Thus, through collective action or by government regulation, the prices are raised in the more inelastic local or regional fluid market and the residual, milk supply not sold for fluid uses, is dumped in the national manufacturing market at whatever price it will bring. Unfortunately, the local or regional pooling for payments to producers results in reduced prices for producers who sell only for manufacturing uses and in markets with only small use of milk in fluid products.

Obviously, the inter-market or interregional impacts of the pricing programs have created regional conflicts among producers and their representatives regarding how the federal order program should be applied or, if it should be applied. The classified pricing systems that benefit producers in markets with high fluid use comes with a penalty of lower prices for producers who rely primarily on manufacturing milk markets. Or, when manufacturing milk prices were at support, it generated increased federal price support purchases to maintain the support price for manufacturing milk. Ironically, in the latter case, the manufacturing milk producers are then criticized for generating the surplus acquired by the price support program. The inequities of this situation has divided producers and their representatives in the Upper Midwest from those in other parts of the U.S., since almost the initiation of the federal order program. A legislative proposal by Congressman Gunderson in 1995 would have significantly reduced the regional inequities of the Federal Order program by operating a national pool for the distribution of returns from the discrimination schemes. Unfortunately, the demographics of the U.S. that determine political representation in Congress are such that majority support for such a change was not forthcoming.

State Milk Pricing Controls

State intervention in milk pricing parallels that of federal milk marketing orders, sometimes in place of federal orders, sometimes by joint regulation with federal orders. Where used, they frequently regulate processor buying prices for milk according to use and pool the revenues for payment to producers in the state. Some state programs have established quota plans whereby producers were allocated shares in the local fluid milk markets. Some state milk pricing programs establish minimum wholesale and retail prices for fluid milk products. Ten states currently regulate producer prices and five states regulate resale pricing. More than three-fourths of all states have, at some time since the 1930's, experimented with state regulation of milk prices.[2]

As with federal milk orders, support for state control of processor buying and producer milk prices is attractive to producers because of its potential to increase producer prices and income by price discrimination. State milk pricing is popular because many producers and their cooperatives believe that the state programs permit them to raise fluid use prices and, therefore, producer prices above federal order minimums or unregulated market levels. According to Manchester, milk programs often resulted in higher fluid use prices than the nearby federal order markets.[3] As with federal classified pricing programs, state controls cause inequities among producers in the different states, effectively reducing milk prices in manufacturing or low fluid use markets.

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[2]Manchester, Alden, "The Public Role in the Dairy Economy," Westview Press, Boulder, Colorado, 1983, pp.169.

[3]Ibid. p. 173.

Fortunately for producers in manufacturing markets, the ability of states to raise returns by raising local prices for milk in fluid uses has been limited. Our courts have consistently, and as recently as 1994-95, held that the 'interstate commerce' clause of the federal constitution prevents the states from either imposing those prices on milk from other states or from preventing milk at lower prices from coming into the state.

Foreign Trade Programs

Dairy import controls under Sec. 22 of the Agricultural Adjustment Act of 1933, as amended, were first initiated in the early 1950's to limit imports that were attracted by relatively high domestic price support and which were increasing the cost of domestic price support. Public Law 480 (Food for Peace) in 1954 provided for use of surplus agricultural products acquired for price support, including dairy products, for economic development programs in LDC's. The Dairy Export Incentive Program, (DEIP), authorized in the 1985 Farm Legislation, provided for direct subsidies on exports of dairy products by commercial exporters through bids on export subsidies. It had the dual objectives of (1) reducing costs of price support, and (2) developing commercial foreign markets for dairy products.

The approval of the GATT in 1995 has committed the U.S. to specific changes and limits on dairy trade. It requires our dairy import quotas be converted to tariff equivalents and reduced by 15 percent by year 2000, provide a minimum access of 5 percent of our domestic market to foreign suppliers by year 2000, and reduce the amount of dairy products that can be exported under subsidy such as those under the DEIP program. We're required to reduce internal support by 20 percent from 1986-88 levels, convert all non-tariff barriers to tariffs and reduce by 15 percent from the 1986-88 level to 2000. The volume of subsidized exports is to be reduced by 21 percent and budget outlays for subsidies by 46 percent by 2000. This will require a 40 percent reduction in subsidized nonfat dry milk exports. Although these are some significant changes for the U.S., other countries also are required to make adjustments. Most rigorous studies of GATT impacts indicate that the U.S. will be a strong competitor in world markets with lower trade barriers.

Changes in Dairy Pricing under the FAIR of 1996

The Federal Agriculture Improvement and Reform Act of 1996 included the following specific features with respect to U.S. dairy pricing regulations:

1. Milk Price Supports:

    - Provides for price support through 1999, but at annually reduced levels ($.15 per cwt) for 1996 through 1999. Support for milk prices, if needed, will continue by government purchases of butter, nonfat dry milk or cheese.
    - Replace price support with a recourse loan program for processors for butter, nonfat dry milk and cheese beginning in 2000.
    - Producer assessments to defray some of the costs of market intervention since the early 1980's, are no longer required.
    - Suspends the price support provision of the 1949 Agricultural Act on milk price supports until December 31, 2002.

2. Federal Milk Marketing Orders:

    - The Secretary of Agriculture is directed to consolidate the current system of 33 federal orders into 10 to 15 orders within a period not exceeding 3 years.

- The Secretary is authorized to use utilization rates for milk in different uses and multiple basing points for Class I (fluid use milk) pricing and uniform multiple component prices for milk used in manufacturing uses.
- If the reforms of federal orders are not completed in a timely fashion, no assessments on producers and processors may be collected for administering the orders.

3. Foreign Market Promotion and Market Development:

- Fund the DEIP (Dairy Export Incentive Program) to the maximum permissible by the GATT through 2002.
- Continues the federal authorization for development and financing of the national program to promote fluid milk products in domestic and foreign markets.
- Assist the U.S. dairy industry in establishing one or more export trading companies for promoting and exporting dairy products by June 30, 1996, and if not established, to identify an autonomous non-government entity for that purpose.
- Authorizes the National Dairy Promotion Board to use its revenue to develop international markets for dairy products and develop promotion programs within foreign markets for U.S. dairy products.

4. The Northeast Dairy Compact

- Authorizes the six northeastern states of Connecticut, Maine, Massachusetts, New Hampshire, Rhode Island, and Vermont to enter into a 'compact' to regulate the prices of Class I (fluid use milk) within those States.

What reforms or withdrawals from market intervention are implied by these provisions of the FAIR? First, the federal government was effectively eliminated as the primary determinant of price for manufacturing use milk price in the U.S. by 1990. The level of support has been, primarily, a 'safety net' that provided little direct support to U.S. milk prices since 1989. That safety net will disappear in 2000. New legislation could change that outcome. Interestingly, without new legislation, dairy price support will reappear in 2002 with termination of the 1996 Act. Because producer assessments were not extended with the FAIR, producers will receive, an average of 13 to 18 cents more per hundredweight of milk.

Second, the mandated reduction in federal orders to 10 to 14 with authorization for multiple basing points for pricing Class I milk is hardly revolutionary. The number has substantially declined in response to enlargement of areas of competition for fluid milk sales, from 83 in 1963 to 33, currently. The number has declined by 9 since 1990. Consolidation to 10 to 14 orders will do little, if anything, to resolve the inequitable treatment of producers among orders as long as revenues from the price discrimination schemes are pooled within each market and class differentials are based on what the individual markets will bear without attracting alternative milk supplies for fluid use.

Third, the provisions on dairy trade is certainly no withdrawal of government. As a signatory to the GATT agreement and by Senate ratification of that treaty, the U.S. agreed to the conditions noted previously. Not surprisingly, the FAIR mandates the subsidization of exports to the maximum permissible under the GATT through year 2000. Government assistance to the industry to form a dairy export promotion and sales entity and use of funds collected from producers will increase governments role in the export of dairy products.

Fourth, the authorization for a Northeast Dairy Compact is the newest feature of U.S. dairy programs. In my view, if actually implemented, it will be the most regionally divisive regulation ever applied to the U.S. dairy industry. As noted previously, individual states abilities to raise local producer returns at the expense of other producers, particularly those in primarily manufacturing areas has been limited by the 'interstate commerce' clause of the federal constitution. The supporters of the compact see it as a method to raise that region's milk prices by imposing pricing provisions and control on milk from other areas, activities that were largely prohibited to the states. If the authorization for a 'regional compact' withstands legal challenges, its my projection that U.S. fluid milk markets and regions will be more 'Balkanized' than was ever possible under the federal order program.

Conclusions

The FAIR leaves the U.S. dairy markets with as much government involvement as before its enactment and the potential for even greater involvement. The actions on price support for 1996-2002 are essentially meaningless because, by 1996, support was only a safety net. The sequenced reductions in support until 2000, then, only storage loans to processors for managing stocks until 2002, is likely to have little, if any, affect on producer milk prices. Interestingly, in year 2002, the 1949 dairy price support program will become effective without new legislation. Thus, dairy price support will be on the agenda, no latter than year 2001, if not before.

Unless real changes in federal milk marketing orders for equitable treatment of all U.S. milk producers: by administrative decision, by court imposed mandate, or legislation, the inherent regional inequities in that program will continue to divide the U.S. dairy industry. This division will increase further if a 'Northeast Dairy Compact' successfully permits that region to raise that region's fluid milk prices regardless of the implications for the nation's milk markets.

FIGURE 1

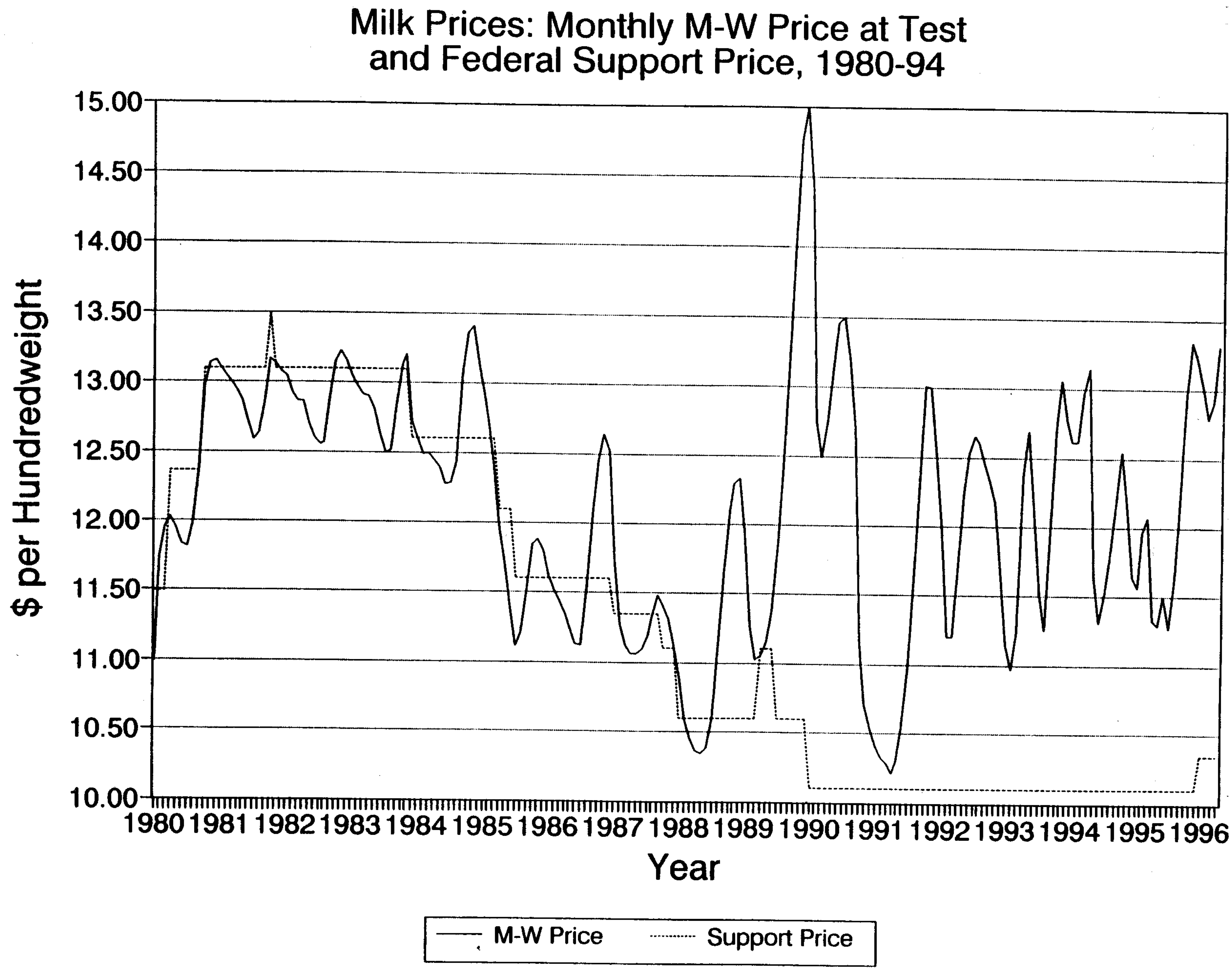
Milk Prices: Monthly M-W Price at Test
and Federal Support Price, 1980-94
$ per Hundredweight
15.00
14.50
14.00
13.50
13.00
12.50
12.00
11.50
11.00
10.50
10.00
1980 1981 1982 1983 1984 1985 1986 1987 1988 1989 1990 1991 1992 1993 1994 1995 1996
Year
M-W Price
Support Price

FIGURE 2

MARKETING AREAS UNDER FEDERAL MILK ORDERS AS OF JULY 1, 1995