January 1987 A.E. Ext. 87-2

Proceedings of the

CORNELL CONFERENCE ON MANDATORY SUPPLY MANAGEMENT PROGRAMS FOR THE DAIRY INDUSTRY

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Sheraton Inn
Syracuse, New York
November 13, 1986

Sponsored by New York State College of Agriculture and Life Sciences
Cornell University

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INTRODUCTION

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One of the most frequently discussed and debated topics among dairy leaders today is whether or not the U.S. should adopt a policy of mandatory supply management for milk.[2] The intent of such programs would be to readjust total production to be in line with prevailing commercial use of milk and dairy products by restricting the amount of milk each producer could sell.

The debate among industry leaders has been spurred by fears that the problems encountered throughout the 1980s will persist if current policies are not changed. These problems include:

- huge surpluses of dairy products resulting from production levels that greatly surpass commercial use;
- high costs associated with removing these surpluses via the dairy price support program;
- erosion of farmer income and equity due to declining raw milk prices; and
- growing attrition rates for family dairy farms.

Some are also convinced that recent attempts at "voluntary" forms of supply management such as the milk diversion and whole herd buyout programs have limited effectiveness and do not offer a long-term solution to these problems.

The adoption of a national mandatory quota program for milk would be a significant departure from past and current dairy policy in the U.S. Under any mandatory program, all dairy farmers currently in business would be issued a base or quota that would be derived from some recent history of their actual milk marketings. Based on the ratio of estimated national consumption to the total of all producer bases, each producer would be allowed to sell an amount of milk (at the quota price) equal to their base multiplied by this national

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[1]The author is an Assistant Professor in the Department of Agricultural Economics at Cornell University.

[2]While the terms "mandatory supply management," "production controls," and "quota programs" are not necessarily synonymous, they will be used interchangeably throughout this manuscript. In the context of this paper, these terms are defined broadly as any policy designed to balance aggregate production with prevailing consumption by mandating all producers to cut back their existing production levels. The key distinction between mandatory and voluntary supply management programs is that the former requires participation by all farmers while the latter requires participation by only those interested in joining the program.

consumption-to-base ratio. In other words, producers would be given the "right" to market certain quantities of milk and would be penalized for either selling over or under their assigned quota. By contrast, past and present dairy policy does not interfere with farm-level production and marketing decisions.

Existing dairy farmers would not be the only individuals affected by the adoption of a national milk quota system. In varying degrees, virtually all segments of society would feel the impact of such a national policy change. For example, the policy would likely have a negative impact on the next generation of farmers, since new entrants would have to purchase quota in order to sell their milk without being penalized. On the positive side, taxpayers would likely experience some benefits of reduced budgetary costs for dairy programs if such a policy was adopted. However, since a quota program would likely raise milk prices, the result would be a transfer of costs from taxpayers to consumers of milk and dairy products. In this respect the policy could be viewed as regressive, since lower income groups spend a larger proportion of their income on dairy products than other income groups.

As a result of the intense interest as well as the tremendous implications a national quota program would have on all segments of society, the New York State College of Agriculture and Life Sciences at Cornell University sponsored a day long conference to explore the major issues and ramifications this policy would have on the dairy sector.[3] These proceedings are a summary of the papers presented at this conference.

It cannot be overemphasized that the purpose of Cornell University in sponsoring this conference was <u>not</u> to endorse or oppose mandatory quotas nor to suggest that we believe this type of program should or will be adopted in the near future. Rather, the purpose of this conference was to foster a better understanding of mandatory supply management by taking an objective, in depth look at the characteristics, issues, and implications of these programs. It is obvious that the debate over whether quotas would be good or bad for the dairy industry is a highly-charged, emotional issue. Because of this, the sponsors of the conference have the difficult task of trying to remain neutral, but at the same time present the various points of view on this issue. Hopefully, the conference program and proceedings have met the goal of presenting the facts objectively and increasing the understanding of the various issues related to mandatory supply management for the dairy industry.

The conference was organized into five sessions and the sections of the proceedings follow the same structure. The first session was entitled "Perspectives on U.S. Dairy Policy: How We Got to Where We're at and Where Do We Go From Here." The proceedings include papers by Judson Mason and Hollis Hatfield which helped set the stage for the rest of the sessions by reviewing past and present problems in the dairy industry and the resulting policy

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[3]The Cornell Conference on Mandatory Supply Management Programs for the Dairy Industry was held on November 13, 1986 at the Sheraton Inn in Syracuse, New York.

responses. In a more forward looking vein, this session also included Robert Jacobson's paper, which explores future directions for national dairy policy.

The second session was entitled "Considerations in the Design and Implementation of a Mandatory Supply Management Program." The intention of this session was to discuss quota plans in general as well as to examine specific proposals. The proceedings contain Ed Jesse's paper, which describes the mechanics of implementing milk quotas in the U.S. with specific attention given to unique aspects of U.S. milk production and marketing that might have some design implications. This paper also raises some of the potential problems that could be encountered in implementing a quota program.

The third session, entitled "Potential Impact of Quotas on Economic Efficiency and Equity Among Producers," focused on general impacts of the program. Stephen Kerr's presentation on the subject is included in the proceedings.

In a slightly different vein, the fourth session consisted of a debate between Ronald Knutson and Bernard Stanton on the question "Do We Really Need Mandatory Supply Management?" The format provided an opportunity for each participant to present his arguments followed by two ten minute rebuttal periods. The proceedings contain the initial presentation of each speaker.[4]

The conference ended with a session entitled "On the Politics of Dairy Legislation," which was intended to provide insight on the Congressional procedure for responding to new proposed legislation. Featured speakers were Congressman James Jeffords and Ronald Allbee, whose remarks are included in the proceedings. Their remarks reflect their judgements on the feasibility of Congress enacting a mandatory supply management program in the near future.

The proceedings provide a comprehensive view of the major issues raised in the selected sessions. Earlier the point was made that a change in policy towards mandatory supply management would represent a drastic move with far reaching consequences. If we need to "look before we leap," the debates and discussions carried on at this conference will provide a valuable first insight.

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[4]The rebuttals between the speakers were tape recorded. To obtain a copy of these tapes, contact the editor of these proceedings.

EXPERIENCE IN THE 1950'S AND 1960'S

Judson P. Mason[1]

Federal programs affecting milk production and marketing in the 1950's and 1960's were centered on price supports, food distribution, import limitations and marketing orders. They are today. They are all interrelated, but I am limiting my remarks to the price support issue.

A brief look at the earlier history of national efforts to stabilize prices and enhance dairy farmer income may be helpful. This takes us back to January 9, 1930, when the federal farm board made a loan to Land O'Lakes Creameries, Inc., to finance the withholding of butter from the market to cushion the seasonal price drop in an already depressed market. About five million pounds were withheld for release back to the trade later in the year.

The agricultural adjustment act of 1933, however, was the first national legislation enacted that was specifically aimed at adjusting agricultural production as a means of increasing farm prices and enhancing farm income. with "parity" as a term came into being and "parity prices" the ultimate goal, to be achieved over time. Production adjustment, or supply management was the intended technique to be used.

The early advocates believed this could be accomplished for all agriculture by directing attention to a limited number of basic commodities, corn being an example. Resource adjustments would take place and producers of all commodities would benefit. Political trade-offs were made in selecting the list of basic commodities. Milk was not among them, but in many respects was entitled to the same benefits.

While the program was being developed, it became quite evident that the dairy cooperative leadership and their members were highly skeptical of government intervention and how it might affect their marketing operations. Innumerable meetings were held among dairy farmers throughout the nation, and it became clear that they would not approve production or marketing quotas. The fluid milk marketing cooperatives were deeply concerned as to how it might affect base-excess plans being widely used to reduce the seasonality of milk production and to restrict entry to what was perceived to be their markets. Dairymen favored federally enforced marketing agreements and licenses so long as they did not materially interfere with arrangements between cooperative associations and their members. Also they favored use of government funds to purchase dairy products for relief feeding, as means of stabilizing prices and expanding markets.

By mid-1933, the Secretary of Agriculture had authorized Land O'Lakes to purchase limited quantities of butter for resale to the government, for relief feeding. This was followed in October by formation of a dairy marketing

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[1]The author is the former Director of Economics for the National Milk Producers Federation.

corporation to develop and operate a dairy program. The stockholders were the National Cooperative Milk Producers Federation, the American Association of Creamery Butter Manufacturers, the International Milk Dealers Association, and the National Cheese Institute. This group was unable to reach agreement on prices or how the program should function, and the effort was abandoned. USDA then commenced buying dairy products on the open market for relief feeding, without commitment as to prices or volumes. The pyramiding of unwanted inventories and excessive government costs were avoided.

Dairymen were not convinced that the Department of Agriculture was in the best position to engage in such operations. They contended that the cooperatives, being more sensitive to market operations, could do a better job. In 1938, the Dairy Products Marketing Association (DPMA) was organized by eight regional butter marketing cooperatives, with the blessing of the Secretary of Agriculture.

The Commodity Credit Corporation (CCC) loaned funds to DPMA for use in purchasing and handling butter for resale to the government. For the first time, an assured minimum price was announced at which DPMA stood ready to purchase unlimited quantities of butter during the seasonal peak production season. Many led themselves to believe that the market would stabilize at the announced price and that DPMA purchases would be minimal. DPMA, however, purchased sizeable quantities of butter. To the maximum extent it was set aside for government use. The excess supplies were to be released back to the trade at such time and in such manner as not to disrupt the market.

Many feared that the program would break down of its own weight, as there was a tendency to announce too high a purchase price and then to hesitate to release butter back to the trade because of the price depressing affects of the market during the fall and winter months. Inventories did accumulate, as did DPMA's liability to the Commodity Credit Corporation.

The European war, however, saved the day for DPMA. The butter in storage became a valuable asset, and was wiped out to fulfill government needs. Price stabilization faded into the background. Attention was turned to means for encouraging increased milk production.

The Secretary of Agriculture entered into a brokerage arrangement with DPMA to acquire dairy products. He then announced that USDA would support dairy product prices, by open market purchases of butter at not less than 31 cents per pound Chicago, for the period April 3, 1941 through June 30, 1943. This marked the beginning of government price assurance to the dairy industry, without regard to quantities that might be offered or to government costs. This commitment of assuring minimum prices was extended by enactment of the Steagall Amendment to the War Powers Act, July 1, 1941, which mandated price supports at not less than 85 percent of parity for all nonbasic commodities for which the Secretary of Agriculture requested by public announcement increased production to meet wartime needs. This marked the first time that a minimum price for dairy was mandated by legislative action.

In response to this directive, the Secretary announced support prices for evaporated milk, nonfat dry milk and cheese, August 29, 1941, and he increased the already announced butter price, November 28, 1942. The 85 percent of

parity minimums were to run through December 31, 1948. The percentage of parity was increased to 90 by further legislative action in October 1942, and the time was extended to two years following the end of hostilities.

These measures of price assurance to farmers was in conflict with government efforts to control prices generally. This was overcome, in part, by making direct payments from the treasury to farmers, and by subsidizing butter and cheese manufacturers and to some extent fluid milk processors.

The contention was that price assurance was necessary to encourage increased milk production for the war effort, and that price assurance should be extended beyond the end of the war to enable dairymen to adjust back to peace time production and marketing conditions. Little concern was expressed about possible inventory buildups or program costs; or how farmers could be expected to adjust to postwar marketing conditions while being assured that their prices were insulated from the market.

Injection of the mandatory support level as a percentage of parity made income enhancement the primary goal without any safeguard against excessive government purchases or government costs--a blank check operation.

As it turned out, however, market prices for milk generally exceeded the support level well beyond the end of the war. The government's need for dairy products continued, for our occupation troops and they played a major role in feeding war-torn Europe and other areas.

After the war, the support level at 90 percent of parity was extended through 1949 by the Agricultural Act of 1948.

It should be noted that except for the initial 1933 proposal to control milk production or marketings, the issue of supply management did not surface again until the debate preceding passage of the Agricultural Act of 1949. At that time, the choices insofar as dairy was concerned boiled down to: 1) continuing the price support at 90 percent of parity, with quotas if necessary to contain production and government costs, 2) allow prices to drop to market clearing levels and make direct payments to farmers for limited quantities--another form of supply management, or 3) authorize the Secretary of Agriculture to establish the support level within the range of 75 to 90 percent of parity as necessary to assure an adequate supply.

The dairy community, speaking through their organizations, adamantly opposed both quotas and direct payments. The legislation, as enacted, authorized the 75 to 90 percent of parity range which was a definite step away from income enhancement toward a more market oriented economy. The price necessary to assure an adequate supply, and not parity, was the governing factor as long as 75 percent of parity was not excessive. However, the percentage of parity rather than a price consistent with marketing conditions became the issue.

In the first two years under the 1949 Act, the support level was first set at 80 and then increased to 86 percent of parity. The market price, however, was higher. CCC purchases were of little significance, except for nonfat dry milk, resulting from the wartime conversion from farm separated cream to whole milk marketings by farmers.

At the beginning of the 1952-53 marketing year the support price was again increased to 90 percent of parity. Farmers responded by increasing production resulting in CCC purchases, inventories, and program costs to increase.

President Eisenhower took office January 20, 1953, and his administration was dedicated to a more market oriented agricultural economy. Secretary of Agriculture Benson indicated intent to lower the level of price support on April 1. Producer representatives objected strenuously. They requested continuation of the 90 percent of parity support level for another year, to provide them time to come up with their own plan to support the price and bring milk supplies more nearly in balance with market requirements. DPMA by that time had been phased out.

The support price was maintained at 90 percent of parity until March 31, 1954. Net purchases mounted to 25 percent of butter production, 36 percent for cheese and 53 percent for nonfat dry milk.

During the year a so-called "self help" plan was the topic of discussion, a warmed over "Brandt Plan" advocated by Land O'Lakes in the 1930's. It contemplated that producers should have a stronger hand in determining the support level; and that they would absorb, by assessment, a portion of the program cost if purchases exceeded government needs. The assessment, or likelihood of one, would be a signal encouraging farmers to cut back on milk production.

The cooperative leadership gave lip service to the self help idea. However, agreement was never reached on program details and it was not solidly supported.

During this year the excessive butter inventory and high government costs captured attention of the media, and the price support program came under heavy fire.

On April 1, 1954, the support level was reduced to 75 percent of parity, from $3.74 to $3.15 per hundredweight of milk. It was held at that price until April 17, 1956. CCC purchases tapered off and went down as did the program cost.

Dairy spokesmen vehemently protested the price reduction and it was soon echoed by their representatives in Congress. The percentage of parity became a political issue. The support price was moderately increased for 1956-57 and was held at the same level through March 31, 1958. CCC purchases, inventories and government costs again crept up and the support level was once more reduced to 75 percent of parity on April 1, 1958. The price established at that time, $3.06 per hundredweight, prevailed until September 17, 1960, when it was increased to 80 percent of parity by legislative action. This happened to be an election year.

The new Secretary of Agriculture, Freeman, increased the support level to 85 percent of parity, March 10, 1961, and the price was extended through March 31, 1962. Again, milk production responded, CCC purchases and inventories went up and government costs mounted.

The Kennedy Administration, being committed to measures to enhance farm income, was reluctant to lower the support level. Instead it was recommended to Congress that legislation be enacted to maintain the support level beyond the 1961-62 marketing year, pending development of a supply management program. This proposal was not enacted. Secretary Freeman, however, appointed an advisory committee, mostly of dairymen, to consider alternative production adjustment proposals, and there were many, including one involving direct payments.

Again agreement could not be reached. There was a deep division between those who viewed supply management as detrimental to the dairy industry and those interested in preserving a market share and restricting entry. They parted company, perhaps to a greater extent, over program details.

Meanwhile CCC purchases and inventories continued to build, the cost of the program again became headline news, and on April 1, 1962, the support level was dropped back to 75 percent of parity. The price established, with minor variations, was maintained until March 31, 1966. During this period again CCC purchases and government costs receded.

Then on April 1, 1966, the support level was increased, as it was again on June 30 of the same year to just short of 90 percent of parity. Milk production again climbed as did CCC purchases and government costs. History again repeated itself, demonstrating that production and marketing forces cannot be ignored in setting prices and that the dairy industry cannot be isolated from the balance of agriculture or from other external forces affecting the business.

Nevertheless, with prospects in sight for another price reduction of some magnitude, attention turned once more to supply management as a way out.

A detailed supply management program was developed by the National Milk Producers Federation, for discussion without being committed to support it. Numerous meetings were held throughout the country. The wisdom of a supply management program was again questioned but most of the discussion centered on details. A great deal of concern was expressed as to how a national program could be dovetailed to the various regions of the country and their differences. In a similar vein questions were raised as to how such a national program could be dovetailed to base-excess and other plans used for distributing returns in fluid milk marketing areas, or with programs operated by state governments, such as California. Other matters were the selection of the base period, the capitalization of quotas, landlord-tenant relationships, the transferability of quotas from farmer to farmer and region to region, provisions for market entry, especially for young farmers.

Some did favor the concept of quotas, but the supply management program did not receive endorsement at a single meeting at which I was in attendance. Conditions took a turn for the better, and supply management was shelved.

The discussions over the 1969 quota plan virtually paralleled those of 1933 and 1961, even though dramatic changes had taken place in production and marketing conditions. The same discussions are taking place today.

In reviewing the history I have omitted a great deal in the interest of time. Among the omissions are the early requirement to support the price of butterfat as well as milk, the parity equivalent price for manufacturing milk, the drifting of dairy policy from that for other agricultural products, and dairy product import limitations.

The price support program, as envisioned by the Agricultural Act of 1949, has served a worthwhile purpose in undergirding the market and preventing severe price drops of a short-term nature. However, it cannot be used as an income enhancement measure without generating excessive surpluses and government cost which then must be addressed.

The purpose of the program has been, and is, to overlook market signals as they appear on the horizon. The support price, in too many instances, has been maintained when the market signals indicated otherwise. If the program is to function successfully, the Secretary of Agriculture must have sufficient discretion to adjust the support level as necessary to reflect signals inherent in a market oriented economy.

This recitation of the history of price supports and the experience in the 1950s and 1960s would be incomplete without a conclusion.

It is my view, and I am confident it is shared by the great majority of dairymen, that a market oriented program is far superior to any supply management program that might be devised, agreed upon and enacted into law. Supply management would weaken the competitive position of milk and milk ingredients, adversely affect market development efforts, attract foreign produced products to the American market, increase production costs, decrease production efficiencies, stand in the way of production area adjustments and in no manner serve the public interest.

DAIRY POLICIES OF THE 1970s TO THE PRESENT

Hollis A. Hatfield[1]

One conclusion that all of us can concur with is the rapidity in recent years with which dairy legislation is being enacted. Only about five dairy bills, including the Trade Agreements Act of 1979, were enacted during the decade of the 1970s while some 12 bills have already become law during the first five and one half years of the 1980s. And between the time this paper is written and the date of this conference, a bill relating to the capital gains treatment for participants in the herd buyout will be in place.

In reviewing the dairy policies of the '70s and '80s, I will not be all inclusive; that is, I will not reference such provisions as food distribution programs, dairy indemnity programs, seasonal base and Louisville plans, farm income criteria, various studies, etc., but will concentrate on the major policy provisions.

The 1970s

Continuing this review of dairy legislation from the period so ably covered by Judd Mason, the Agricultural Act of 1970 extended the Class I base plan authority under federal orders, maintained the support level between 75 and 90 percent of parity, and suspended the support price for milkfat in farm separated cream to deter an increase in nonfat dry milk purchases.

The Agriculture and Consumer Protection Act of 1973 extended the authority for establishing Class I base plans, altered the minimum support level from 75 and 80 percent of parity, provided that a hearing be held on a proposed federal order amendment if one third or more of the producers in an order apply in writing (prior to this change, hearings were held at the discretion of USDA), and made permanent the suspension of the milkfat price support for farm separated cream. This latter provision probably was the first major policy change during the early 1970s permitting the CCC purchase price for butter to be set at less than the applicable support level.

The Food and Agriculture Act of 1977 raised the minimum support level to 80 percent of parity, but at that time conditions were such that the support price had been in the range of 80 percent in recent years. A more significant change, and one that helped motivate a reversal of the 33-year downtrend in cow numbers, was the provision that the support price be updated every six months for the next four years.

In the context of dairy policy, the 1977 Act was a turning point away from a program that had a good track record--the 1949 Act. During the 29-year

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[1]The author is Director of the Dairy Division at the American Farm Bureau Federation.

Support Price Trend

The support price rose $6.83 per hundredweight during the decade of the 1970s; peaked at $13.10 in the early 1980s; and is expected to be down $2.00 per hundredweight from its peak by October 1, 1987. The trend in the 1980s appears to be the opposite of the 1970s. When this trend is coupled with the continuing efficiencies of production, will a $10.00 or possibly lower support price soon be a standard for the industry?

The Fewer Cow Syndrome

If the nation's milk supply is to be brought into a reasonable balance with market requirements, fewer cows will be milked. Fewer cows means fewer dairymen. And this is another reason why interest is being expressed for some type of supply management. But I would hasten to add that preserving the status quo has not been a hallmark of quota programs. We need only to look at Canada's experience.

The nation's dairy herd totaled 11.1 million cows just prior to the herd buyout program. Allowing for a substantial increase in commercial sales, my estimates show that about 8.4 million cows will be adequate to supply the market in the year 2000. I have seen estimates as low as 7.8 million cows. But, again, in historical perspective, what is new? The projected decrease of 2.7 million cows by 2000 is a continuation of a trend that has been occurring for decades, but was derailed in 1980. And placed in perspective, the projected decrease would average 192,857 cows per year; small relative to the 1944-1979 period average annual decline of 425,714 cows.

We have contended for decades with an increase in production per cow that more than offset the gain in demand. Cow numbers declined. But when an increase in cow numbers is coupled with the increase in output per cow, the industry is faced with what I describe as a double whammy. And this is the situation that we have been in since 1980--by far, the longest such period in dairy program history.

Mandatory Controls

The central issue being shaped throughout the country is whether the milk supply should be regulated by a market driven program or by a government mandated control program.

A review of farm program history shows that whenever government surpluses have mounted to a relatively high level, mandatory controls have been advocated. Most of us at this conference have participated in such debates. In 1972, for example, the dairy proposals being considered fitted under one of the following four categories:

* Continue present program (Act of 1949);
* Lower the support price;
* Implement a nationwide surplus cost-sharing program; or
* Impose supply controls.

A featured topic at the 1972 Northeast Dairy Conference was "Why the Northeast Should Adopt a Supply Management Program." The speaker was Truman Graf from the University of Wisconsin. Supply control was a front burner issue in 1977, 1982, 1984, 1985, and now in 1986. In 1977, the quota talk was short-lived--escalating beef and grain prices curbed milk production for two years. A few cooperatives have implemented quotas from time to time, but no nationwide quota type supply management dairy program has been implemented to date in the United States.

In the context of supply management, we might slam the program to refund producers for cutting marketings or the diversion program as feeble efforts to curb the nation's milk supply. In this aspect, the programs failed before they began. But if you are a serious proponent of supply management, perhaps you are thinking otherwise--that these programs were not futile because many dairymen have become familiar with marketing history, base forming periods, and base computation, all major hurdles to supply control.

Farm Program Tenure

Our Economic Research Division analysis of the current law shows that it will likely produce convergence of production and consumption sometime in the early 1990s. But will we stick with the Act of 1985 that long? Although the Act has an expiration date some four years hence, the experience of recent years indicates that a three-, four-, or five-year farm program has little meaning today. Considering the relatively large number of dairy program alterations in recent years, it is little wonder that many of the nation's dairymen are frustrated.

The debate is already underway to alter the provisions of the Act of 1985.

FUTURE DIRECTIONS FOR DAIRY POLICY

Robert E. Jacobson[1]

Occasionally someone lifts up the line out of Alice in Wonderland that--if you don't know where you're going any road will get you there. I sometimes think that that observation describes future directions in dairy policy.

We clearly have two schools of thought out here in the milk industry. One is the market oriented-safety net school. It believes that milk prices should be made in the marketplace most of the time. There should be a price support program, but it should only become visible for short periods of time when some abnormal situation is placing sharp downward pressures on the level of milk prices. A couple of years ago I participated in one of those safety net projects where we defined the milk price safety net as--"a long run price which over the course of 10 years or more should average below the long run market clearing price by 5-10 percent."

Yes - a support price should be there.
No - the support should not determine or influence the M-W except in short-run situations.

The dairy title of the 1985 Farm Bill was a definite turn in the direction of the market oriented-safety net school. In fact, if you believe that the future is the next four years, AND if you believe that no new dairy legislation is going to emerge prior to late 1990, then you already know what the future direction of dairy policy is. Most of us are familiar with the downward spiral intended for support prices, which are listed below.

Year	Support Price (3.67% BF)
1986	$11.60 per cwt.
1987 (January-September)	11.35
1987 (October-December)	11.10
1988	10.60*
1989	10.10*
1990	$ 9.60*

* Assumes over 5 billion pounds m.e. CCC purchases for each calendar year 1988, 1989, and 1990. Support prices could be increased 50 cents in 1988, 1989, and 1990 if projected CCC purchases each January 1 are less than 2.5 billion pounds m.e.

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[1]The author is a Professor in the Department of Agricultural Economics at The Ohio State University.

The $9.60 support price is $3.50 below (minus 27 percent) the $13.10 support price that prevailed in the 1981-1983 period. A dairy policy of market orientation for the next four years is clear on two scores: (1) the systematic descent in support prices, and (2) the supply-demand adjuster hooked onto the price support decisions for 1988-1990. Add to that the authority for a second dairy reduction program that may be established in 1988, 1989, and/or 1990, and it becomes clear that (1) prevention of surplus milk is fundamental, and (2) price is the flagship for achieving supply-demand balance. That is today's policy.

The market oriented school is in a bit of euphoria at the moment because the October M-W was announced at $11.69, 38 cents above the support price. The Chicago butter price is running 14 cents a pound over the CCC purchase price, and 40 pound blocks of cheddar cheese are trading at 5 1/2 cents a pound over the CCC purchase price of $1.25. In the autumn of 1986, the market is working--with a big boost from the whole herd buyout program. The market oriented school, for the most part, does not believe that producer milk prices will follow the downturn in support prices, but instead will reach equilibrium levels well above the support price.

The second school is the supply management school. Just because you're participating in this conference today doesn't mean you're a student of the supply management school.

Supply management has various gradations, from voluntary approaches with incentives through mandatory approaches with penalties. Even today, the National Milk Producers Federation is discussing at least four different versions of supply-management. We have proved as an industry and as a matter of public policy that some forms of voluntary supply management are acceptable implementations of dairy policy. The 50-cent rebate program in late 1983, the diversion program in 1984-85, and the whole herd buyout program in 1986-87 are manifestations of the fact that voluntary supply management programs implemented as short term Band-Aids may be useful. More importantly, these fairly modest supply management actions have been breakthroughs in the historic "don't tread on me" attitude of the milk industry toward production controls.

In a sense, the diversion program and the whole herd buyout program have only whetted the appetite of the supply management school. In the fall of 1984, the M-W jumped by 60 cents per cwt. because 39,000 milk producers had contracted to cut production. This fall, the M-W has already jumped 70 cents because 14,000 milk producers contracted to quit production.

Milk production dropped 3 percent in 1984 because there was supply management. Milk production jumped 7 percent in 1985 because there was no supply management.

Even today, many of us are looking for a rapid buildup in milk production in the second half of 1987 and in 1988 as the Dairy Termination Program fades behind us. Why shouldn't we think that way--look what happened after the diversion program. History has some lessons.

Regardless of the school you're in, all of us are agreed that dairy price policy is going to have to do a better job of achieving supply-demand balance than has been the case in recent years. The 16.8 billion pound milk equivalent

surplus in 1983 was a disaster, and we've seen too many surpluses in the 10, 12, and 14 billion pound range in the 1980's. At current support levels, one billion pounds m.e. of CCC purchases costs the government about $150 million. The 5 billion pound maximum surplus implied in the present dairy program suggests that the government is willing to spend up to $750 million a year for dairy products. That may not sound like supply-demand balance, but it's a lot closer to it than anything we've seen in recent years.

The supply management school argues that price will not achieve supply demand balance in the next four or five years, or even ten years. These disciples are convinced that the technology of milk production is coming on so strong that we will continue to see more milk at lower costs, almost regardless of price level. Milk production per cow in the U.S. was at a record 13,031 pounds in 1985, an increase of 525 pounds per cow over 1984. It will be up almost another 400 pounds in 1986. We all hear constantly about the isoacids, the bovine growth hormone, the embryo transplants, further genetic engineering, computerized breeding, three times a day milking, and what DHIA is going to mean in the future.

The recent analyses conducted by the Office of Technology Assessment give the supply management school a huge supply of fuel. Listen to their words--"The most dramatic impacts [of emerging technologies] will be felt first in the dairy industry.... New technologies adopted by the dairy industry will increase milk production (per cow) far beyond the 2.6 percent annual growth rate of the past 20 years. Under OTA's most likely conditions, milk production per cow is expected to increase from current levels to at least 24,000 pounds by the year 2000, an annual growth rate of 3.9 percent."[2]

While I personally am very skeptical about the OTA projections, the point is that in the case of dairy, it is the fear of a yet to be implemented technology that is the banner in front of the supply management school. This is different from the feed grains, for example, where the stress of currently low prices is the rallying point for changes in the farm program.

Let me do a little more stage-setting for the supply management school. In the latest issue of Choices, John Schnittker, former Deputy Secretary of Agriculture, had these things to say about dairy:[3]

- Dairy excess capacity is in the neighborhood of 8-10 percent of milk production. Worst of all, it seems likely to increase over time because of declining feed costs and rising productivity.

With that premise, Schnittker gets political and makes the following points--

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[2]Technology, Public Policy, and the Changing Structure of American Agriculture, Office of Technology Assessment, U.S. Congress, OTA-F-285, March, 1986, p. 11.

[3]Schnettker, John A., "Coping with Excess Capacity," Choices, American Agricultural Economics Association, Third Quarter-1986, pp. 7-12.

"The most compelling political scenario for revision of the farm support system in 1987 would develop--

- if Democrats gain four seats in the U.S. Senate,

- if grain stocks are forecast to increase in 1987 and again in 1988...,

- if the whole herd dairy buyout reduces milk production temporarily but only by 3-5 percent after 8.5 percent of milk production was bought out,

- if realistic expectations are for a new surge of dairy surpluses in 1988,

- AND, if the cost of [all] price support programs is around $25 billion, instead of the officially endorsed $17-18 billion."

"In that climate, the constant urge to rewrite the farm bill would become even stronger."

Somehow, it seems to me that almost all of these conditions are in the process of being met. We all saw the election results nine days ago.

At the present time, it requires a net reduction of 107,000 milk cows in the United States to offset every 1 percent increase in production per cow as we determine total output. A reduction of 107,000 milk cows, assuming an average dairy herd of 63 cows in the U.S. at present, means the required exit of 1,700 dairy farms. When OTA talks about a 3.9 percent increase each year in production per cow, one can see how quickly the pressure on survival of the family dairy farm multiplies.

Of course, the question for future dairy policy is whether society will accept the restructuring of the dairy industry and the losses of the family dairy farm that new technology in conjunction with a market oriented dairy policy are likely to bring about.

At the present time, the dairy sector comes closer to reflecting a family farm structure than any other agricultural enterprise. In the Federal milk order program nationally (approximately 70 percent of all milk, 80 percent of Grade A milk, and 115,000 dairy farms), the average herd size is 63 milk cows. Approximately three-fourths of the dairy farms shipping to Federal order markets have herds that average smaller than 63 cows.

In the studies that the Office of Technology Assessment have reported, the conclusions point to the fact that price support policies that reflect the schedule of the 1985 Farm Act would work against survival of the family dairy farm. Note the following points:

- A 52 cow dairy farm in Minnesota has only a 74 percent probability of survival through the 1983-1992 period with present policies.

- The average net worth of the Minnesota dairy farm would drop from $417,000 to $240,000 through that period.

- Cash income and net income would be negative figures (-$7,000 and -$22,000).

- For large dairy farms (up to 1,436 cow herds in Florida and California), current policy would mean high probability of survival, increasing net worth, and positive income levels.

- With supply management (mandatory production controls), survival probability for the 52 cow dairy farms would increase from 74 percent to 92 percent. Net worth and income would still erode, but not by such large proportions.

- Large dairy farms would perform similarly on survival probability, net worth, and income under either present policies or supply management.

Since three-fourths of the dairy farms in the United States fit the 52 cow herd size model pretty well, it's not difficult to perceive the increasing attraction that supply management holds.

An implicit objective of supply management is to somehow hang on to the structure of dairy farming as we now know it. We know that supply management may not save the family dairy--Canada's version has hastened concentration. But base transfer rules can be made that will solidify current structure.

But that may not be what we want either. The point is this--what should be the objective of dairy price support policy in the future? You might ask, and fairly so, what has been the objective of dairy policy in the past? We hear a lot of fat words on objectives. The 1949 Act states "adequate supply" as an objective, but trying to give that any definition has been useless, at least in the past ten years.

On the one side, we hear parity, or dairy parity, or cost of production, or family farm. On the other side, we hear market oriented or safety net or facilitate adjustment or encourage demand. One would think we would have to make a choice; historically we have chosen both. That's partly why we are in the fix we have been in in the 1980's--surpluses even while producer milk prices run at 53 percent of parity.

Supply management, by definition, means we are choosing an objective of price enhancement--of establishing producer milk prices significantly higher than long run market clearing prices. If this were not the case, then we would not have to concern ourselves with production controls.

Are we ready to make that choice? I doubt it. Our objectives will continue to be, simultaneously, (1) help preserve the family dairy farm, and (2) permit market forces to establish price levels in the milk industry. These two objectives are in conflict, so we'll continue to stumble along, searching for various short run measures, such as a whole herd buyout program, that will get us past the current crisis.

Demand also has something to tell us about future dairy policy--but we can't be sure what it tells us. We've all become aware of the remarkable increases in aggregate commercial demand in the past 4 or 5 years.

Year	Commercial Demand
1980	119.5 bil. lbs. m.e.
1981	121.0
1982	122.5
1983	122.5
1984	126.9
1985	131.1
1986	135.0

The rates of increase in the past couple of years have exceeded 3 percent. These increases cannot be explained conventionally. The National Dairy Promotion Board and the UDIA can take their bows. And we know that price has been a factor. Currently, on the Consumer Price Index (1967=100), the general price level is up 3.3 times, retail milk and dairy product prices are up only 2.6 times, and producer milk prices are up even less: 2.4 times. The market oriented school can say, "Look, we told you so--price is doing the job--we can achieve supply-demand balance at reasonable prices."

The supply management school can look at the same numbers and say, "these demand increases have been phenomenal but they absolutely cannot be maintained. If we hadn't had them, look what the surplus situation would have been. We had better get on top of supply control now, because the demand increases are not going to be here much longer."

I find myself more persuaded by the supply management school on the demand issue. We should expect to get about 1 percent annual increases in dairy demand over the long run--far short of projected increases in supply.

I wonder, if we had held this meeting back in 1950, and know what we know today, if we would have pursued dairy policies similar to what we have utilized. In 1950, there were 3,648,000 farms in the United States with milk cows; today there are 270,000 farms with milk cows. In 1950, there were 405,000 commercial dairy farms in this country; currently we estimate that number at 165,000. In 1950, per capita consumption on a milk equivalent basis was 740 pounds; currently we are at 550 pounds per capita consumption (commercial sources). In 1950, production per cow in the U.S. averaged 5,314 pounds; this year we will hit the 13,400 pound mark.

My point is that we have been through as much change in this past generation in the dairy sector as we are likely to see in this next generation. We have paid lip service to saving the family dairy farm, but they have disappeared by the hundreds of thousands. Market forces essentially have prevailed, and I doubt that we would find very many people that would have regrets about the policies we have used or the changes that have occurred.

Is 1986 any different from 1950? Is 1986 a year we would lock ourselves into? Possibly--mostly because of a concern with oncoming technology that bruises some of our traditional values. But is that concern big enough to push us into supply management?

I suspect that our future directions for dairy policy will be more of the same. That means establishing support prices at some level and then seeing how

the market reacts to that price. If milk supplies are short, the support price will be hiked to catch the higher market price. If, as seems to be more likely, surplus milk will be facing us, the support price will be dropped modestly and we'll have another round of a 15 month or 18 month milk reduction program.

I don't know if that sounds like policy or not, but I do believe that it reflects what we're going to see in the dairy program in this next decade. Why not something stronger, i.e., mandatory supply management? Because the majority of milk producers in the United States are not ready to bite the bullet on that one yet.

COMPONENTS AND CHARACTERISTICS OF A QUOTA SYSTEM

Ed Jesse[1]

Use of mandatory supply control in the U.S. dairy sector would represent a major departure from the federal dairy programs of the past. The primary price support mechanism since 1949 has been the dairy price support program, which includes no eligibility requirements. The 1984-85 Milk Diversion Program introduced voluntary production controls, but nonparticipants were unrestricted. The current Dairy Termination program likewise provides no nonmarket disincentives to prevent nonparticipants from expanding milk sales.

The desirable and undesirable features of mandatory supply control are addressed elsewhere in these proceedings. This paper focuses primarily on some of the mechanics of implementing milk quotas in the U.S. Milk quota programs currently in use in the European Economic Community (EEC), Canada, and California are referenced in the discussion. However. unique characteristics of U.S. milk production and marketing suggest some challenges in designing a comparable milk quota program. Dairy provisions of Senator Harkin's "Save the Family Farm Act," which includes producer-approved mandatory supply controls for all major farm commodities, are also referenced in the context of the first concrete U.S. milk quota plan.[2]

Fundamentally, any form of mandatory supply control requires six decisions. These involve: (1) setting the price objective; (2) estimating market needs; (3) establishing production bases; (4) allocating total market requirements to individual producers; (5) setting overproduction penalties; and (6) providing for transfer of marketing rights. The nature of these decisions in a U.S. milk quota program is discussed below.

Establish and Adjust Target Price

This decision differs little from the current price support program. That is, the target price level for milk under a quota plan could be set by formula or fiat. The formula used to move the support price prior to 1981 was based on parity. Congress has specified absolute support levels since 1981, with price adjustments keyed to projected surpluses.

Canadian industrial (manufacturing) milk prices and fluid milk prices in most provinces are set by using a weighted index of production costs and other economic indicators. The same method is used for pricing fluid milk in

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[1]The author is a Professor and Chairman in the Department of Agricultural Economics at the University of Wisconsin-Madison.

[2]The Harkin bill died with the end of the second session of the 99th Congress, but will undoubtedly be reintroduced in the first session of the 100th Congress.

California. In the EEC, milk prices were frozen at existing levels when their quota program was initiated in 1984. The Harkin bill would revert to the parity concept, setting manufacturing milk prices at 70-80 percent of parity ($15-$18 per hundredweight).

Many dairy farmers see price enhancement as the major benefit of quotas. Indeed, milk prices can be lifted to almost any desired level without incurring taxpayer costs. However, the effects on consumption must be recognized; the greater the price enhancement, the greater the necessary cutback in aggregate production. High prices also invite further market erosion from substitute dairy products.

Separate quota systems and pricing formulas exist for fluid and manufacturing milk in Canada. In a U.S. plan, quota prices would more likely apply only to manufacturing milk, with Federal milk marketing orders continuing to price fluid milk. If that were the case, interregional equity problems could surface because of differences among regions in fluid utilization and differences between the price elasticity of demand for fluid and manufacturing milk.

Using the Harkin proposal as an example, the initial price objective for manufacturing milk ($15 per hundredweight) would represent about a 30 percent increase over the current support price. Given typical farm retail marketing margins and the sensitivity of retail demand to changes in prices for cheese, butter, and other manufactured dairy products, commercial manufactured milk sales would likely drop about 10.15 percent. Marketings of manufacturing milk would need to be cut by that amount plus the amount that is now being purchased by the Commodity Credit Corporation (CCC) under the dairy price support program (8.10 percent of total marketings, which are roughly one half fluid use). Hence, the required reduction in manufacturing milk production could be as much as 35 percent.

With current Class I differentials, the target manufacturing milk price under the Harkin proposal would translate into a fluid milk price increase of 20.25 percent in high Class I utilization markets such as the Southeast. This price increase would likely decrease fluid sales by 3.5 percent. In other words, under a quota plan that involved substantial price enhancement, manufacturing areas would be required to reduce production much more than fluid areas. The likely magnitude of the difference suggests that special provisions would need to made to reduce the inequity.

Estimate Commercial Use

The target price level would dictate the volume of milk and dairy products that would clear commercial channels and, hence, the total milk quota. Estimating sales would be a difficult task, especially if the price objective was well above current levels. Economists simply have little knowledge of consumer response to prices that are higher than historical observation.

Flexibility would be need to be built into the consumption forecast to avoid the possibility of shortages. Under the Canadian quota system, industrial milk consumption estimates include a "sleeve" which provides some slack to account for the possibility of individual producers and provinces not

meeting their production goals because of weather, herd health, or other unpredictable factors. Canadian production under quota regularly exceeds commercial use with the excess purchased as nonfat dry milk and exported at world prices. Dairy farmers are assessed a "within-quota" levy to cover the difference between the purchase price and the export value of the nonfat dry milk.

Consumption estimates are not necessary under the EEC milk quota program, since the plan operates in conjunction with a surplus purchase/disposal program and does not tie production quotas to projected sales. Similarly, the California fluid quota program does not require consumption estimates because quota milk that is not needed for fluid is simply priced lower than fluid milk. The Harkin proposal would require the Secretary of Agriculture to estimate annual domestic milk consumption and dairy product exports, but would retain the price support/CCC purchase program that is currently in place to handle any resulting surpluses.

Establish and Update Production Bases

Dairy farmers must be assigned production bases on which the national quota is allocated. Most quota plans assign bases according to historical production, allowing some discretion as to what historical period can be used.[3] The Harkin proposal would use 1981-85 average milk marketings by individuals discarding the high and low years of the 5-year base-setting period.

Quota plans may or may not have provisions for updating production bases and establishing bases for new entrants. "Rolling" or moving average bases encourage base-building, defeating the production control intent of quotas. But fixing bases can penalize dairy farmers who were in an expansion phase during the base-setting period or who otherwise had abnormally low production. Unrestricted allocation of base to new entrants can also frustrate supply control or hurt existing dairy farmers by requiring off-setting base or quota reductions. Severe restrictions on new base, however, can stagnate the dairy industry.

Equity is a major concern in the base allocation process--it is impossible to please everyone. Institution of the California fluid quota system prompted the filing of appeals by about a third of the state's dairy farmers, mostly on grounds of inequitable treatment in the allocation of production base.

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[3]Allowing discretion in selecting a base period is important to promote equity, but at the same time, it can lead to a distorted level of total base relative to production requirements. For example, a Federal marketing order involving producer quotas for spearmint oil was initiated in the Northwest in 1981. The order allowed producers to select from a wide set of alternative base-setting strategies. The resulting aggregate base was twice the level of current production.

Allocate Farm Quotas

Given the national quota and individual farm bases, the assignment of farm quotas is a simple task in a mathematical sense. Each farmer holding base would be allocated a proportional share of the national quota. For example, if total required production (estimated commercial use) was 120 billion pounds and total assigned base was 150 billion pounds then each producer would be granted a quota equal to 80 percent (120/150) of the farm base. This is effectively the way quotas are allocated to the farm level under existing milk plans, and the manner proposed in the Harkin bill.

But this simple process could be unworkable in light of the regional pattern of milk production and use in the United States. It works in Canada and the EEC because milk shipments across provincial and country borders are prohibited. Milk flows freely across state borders and utilization of producer milk varies substantially from state to state in the U.S. A 20 percent cutback in production may be inadequate to balance production and needs in one part of the country. The same time 20 percent reduction might cause severe shortages in other parts of the country.

A proportional allocation of quota would increase interstate hauling costs and distort relative supply and demand conditions. But devising a scheme to allocate quota in relation to regional utilization patterns that, at the same time, maintains equity across regions would seem to require wisdom and understanding superseding Solomon's.

Set Overproduction Disincentives

Keeping dairy farmers within their quotas can be done through absolute prohibitions on production in excess of quota (over-quota milk must be dumped) or through economic penalties. The EEC and Canadian plans use two-tiered pricing in the sense that over-quota milk receives a price close to zero through the application of levies on excess production. The Harkin proposal would apply a levy on over-quota production equal to 75 percent of the target milk price and impose civil penalties on violators.

Seasonality in milk production can cause problems in setting overproduction penalties. The Canadian industrial milk quota plan involves a complex system of projecting likely annual overproduction based on sales to date and adjusting for seasonal patterns. An alternative strategy would be to assign quotas and penalize overproduction on a monthly basis.

Penalties for overproduction may be inappropriate if conditions call for more milk than initially planned or if some producers are unable to fill their quota. Flexibility in imposing penalties may be necessary. The EEC plan, for example, allows for assignment of quotas to milk plants rather than producers. This allows some producers to exceed their farm quotas without penalty to the extent others fall short.

Design Base Transfer Terms

The manner in which base is allowed to transfer among existing and potential producers is crucial in terms of evaluating the potential effects of a quota plan. Three basic policies can be used: (1) ase can be freely transferable, either among existing producers or to new entrants, with its price dictated by market conditions or fixed by regulation; (2) base can be tied to milk production facilities (that is, not permitted to transfer except as part of an existing farm); or (3) base transfers can be prohibited, with the base of exiting dairy farmers reverting to the government for subsequent reallocation.

The Canadian and California quota programs have freely transferable base. California base transfers are negotiated between buyers and sellers. Base in Canada normally trades through organized exchanges, at "market-determined" prices. A "tax" equal to 15 percent of the base volume traded is imposed on exchange trades in Ontario. Base obtained through this tax may either be reallocated or retired. Base transfers between family members are not subject to the tax and do not have to be made through the exchange. Prices for base in Canada and California fluctuate freely in response to milk prices and other economic conditions.

The EEC plan permits base transfer only as part of a farm transfer. However, the value of the base is clearly reflected in land values for farms with base. That is, the value of the base is capitalized into the price of dairy farms. The Harkin proposal would also tie base to existing farms, with several provisions for base transfers and augmentations under special conditions. No current or formally proposed plan would prohibit base transfers. While technically feasible, prohibiting transfer of base would likely distort natural incentives to exit dairy farming or to shift to alternative farming enterprises.

If base is permitted to transfer, either directly or as part of a farm sale, its cost will reflect any price enhancement associated with a quota program. Hence, the cost of production for any farmer acquiring base will be elevated by the direct or implicit cost of the base. In other words, costs will rise to absorb profitability of the quota plan. This is an inevitable result of mandatory supply control, and suggests that the major benefactors will be those who are granted base at the inception of the program.

Tieing base to existing production facilities may serve to reduce the cost of acquiring base, since the resource (base) is made less mobile. But interregional problems are likely. For example, a New York milk producer may wish to expand production while a North Carolina producer wants to quit. The New Yorker is not likely to want to acquire the North Carolina operation in order to acquire its base. This problem would be particularly severe if supply and demand relationships changed substantially among regions. That is, interregional shifts in the location of milk production in response to changes in the profitability of milk production would be stifled by the base transfer rule. Making base freely transferable causes fewer problems in interregional shifts, but results in higher production costs for expanding or new producers.

Base transfer rules influence the effect of a quota program on dairy farm structure. Mandatory supply control has frequently been cited as a means of keeping smaller dairy farmers in business by elevating their returns to more

profitable levels. But mandatory controls cannot eliminate economies to size. If the quota plan results in acceptable profits to small dairy farmers, profits to larger ones are likely to be more than acceptable. Large farmers would bid up the price of base to reflect its greater value to them. Smaller farmers would find themselves in possession of a valuable asset that could be converted to cash by exiting dairying. The only way this phenomena could be prevented would be by preventing the sale of base. The incentive to cash out the base value would be greater the greater the price enhancement associated with the quota plan and the less restrictive the quota transfer rules. Granting dairy base may very well be a socially desirable way of providing a transition payment that would ease the movement of some dairy farmers into retirement or other lines of business. But dairy quotas are not likely to insure the existence of a large number of small dairy farms.

Summary

Dairy quotas have generated considerable interest in the U.S. dairy industry as means of dealing with chronic milk surpluses, high taxpayer costs for price supports, and low milk prices. Other countries have used quotas more or less successfully to deal with these problems.

The milk production and marketing system in the United States is complex, with regional specialization in fluid and manufacturing milk sales, widely divergent costs of production, and shifting interregional profitability patterns corresponding, in part, to a highly mobile population. Consequently, the implementation of a nationwide quota system would be a complex task. Much research and planning would be necessary to design a program that would be tolerably efficient and equitable.

The dairy industry is unquestionably not in the greatest of health. Many dairy farmers face bleak prospects of financial survival. Strong medicine may be needed. Quotas represent strong medicine. They also have profound side effects, some of which we are unable to isolate. Before prescribing quotas, we must be certain that the patient needs the medicine (that is, that other, safer medicines are inadequate) and we must understand and accept the side effects.

ECONOMIC EFFICIENCY, EQUITY, AND MANDATORY QUOTA PROGRAMS

Stephen Kerr[1]

I think it's fair to say, as Hollis Hatfield did, that dairy programs that don't get at cow numbers are destined to fail. If indeed you believe in the trends that he, Bob Jacobson and Judd Mason outlined regarding cow numbers, increasing output per cow and the relationship between the two; if you believe that they are real numbers and not made up by USDA; then you must conclude that, given a projected 2.6% to 3.9% annual increase in output we shall have to continue to reduce cow numbers. I would agree that the problem that we have faced for the last five or six years is, in its simplest form, a 30-year trend in the late 70s. We're now living with the consequences of that. We should probably review supply management in that context. A supply management program that doesn't reduce cow numbers isn't going to work any better than a price cut program that doesn't reduce cow numbers.

We've already tried some forms of supply management, of course. As Bob Jacobson said earlier, we need to define and understand supply management as either a very generic term or a euphemism. The diversion program was certainly supply management. The buyout is a very direct approach to supply management. Production quotas are yet another form. To call one "supply management" and ignore the others is misleading.

I have been asked to consider "winners" and "losers" under a program of mandatory production quotas. In that context, we will look at this question of who wins and who loses. I've broken the question into five separate questions. These may not be all of the questions, but they are some of them.

The first group that we'll look at is farmers. That's the group that's nearest and dearest to our hearts and, obviously, the most important given the kind of people that we are. The first question therefore has to do with <u>current dairy farmers</u> as opposed to <u>all other kinds of farmers</u>, whether they're in dairying or something else. I note that it's unlikely that bases will not take on value. Ed Jesse, who's very well respected on this matter, pointed out that they absolutely will take on value. As a result, I think it is fair to say that, even if bases run with the farm, they will be capitalized in some fashion, probably into the price of the land, as Ed suggests. Farms in purely dairy regions, for instance, those in upstate New York and Vermont that don't have good alternative agricultural opportunities, are going to face a curious kind of question. Farms that have bases are going to be worth more than farms that don't have bases and that's going to create winners and losers in the agricultural sphere all by itself. That's the case in the Midwest under the current corn and wheat program.

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[1]The author is Director of the Legislative Committee of Northeastern Co-operatives and a former aide to Representative Jim Jeffords of Vermont.

Who's the winner? Obviously, those with a base. Who's the loser? Those who don't have a base; pure and simple. If, as Mr. Jesse said, these are assets that have value and that can only be cashed in by selling them, obviously those who have a base will benefit and those who do not, will not. I would also suggest that some farms are going to have more base than others, and that there will be relative winners and losers in that game, too. A person with 25 cows is going to get a 25-cow base; a person with 75 cows is going to get three times the base. If the 25-cow farmer wants to grow, he's going to find that he's a loser relative to the 75-cow farmer because he's going to have to buy base for 50 cows. If indeed economic efficiency has something to do with size, then that's going to be a very serious consideration for that 25-cow producer.

Different generations. What does that mean? What we're talking about, when we're trying to enhance prices, is to enhance profitability. I assume that base is going to be granted because I suspect that the first day that farmers are told that they have to buy their base from the government is the last day that there's much interest in bases. Those who are granted the base obviously will be the beneficiaries in a generational sense because they are being given something of value without paying for it. Those who happened to sell out in the buyout or those who happened to sell out in 1979 obviously are losers in this regard because they have a farm which has no base and is thus worth less than one which does. That may not be terribly important, perhaps, because those people made their choices. What is important, though, is the next generation. We hear continuously that the average age of farm owners is 50-55. If you're to believe that, and you're to ignore the family relationships which I think are masked by that number, you have to conclude that we're looking at a transfer of the farming practice and farming asset of some considerable magnitude in the not-too-distant future. If indeed the next generation has to buy this new asset, as well as the farm, assuming no adjustment in the value of the farm, then their profitability is going to be reduced accordingly. I guess my question then is this. Who's the winner, who's the loser? Clearly the current generation wins in that they were granted an asset which may not really benefit subsequent generations because they have to buy that asset in order to merely milk cows. If their profitability is reduced by that fact, then you have to say to yourself, are they any better off? Or was the gain merely short lived? I'm not sure I know the answer, but those people may indeed be big losers if they're not careful, because under a base plan, they now have had foreclosed certain kinds of business opportunities that dairymen today have in order to adjust their income. Mostly they just can't get bigger very easily.

One of the toughest problems of all has to do with regions. Regions pose a particularly difficult problem, as those of you from the Northeast know. It appears that the winners in the regional battle are those who now have a surplus, or are projected to have one, and who are probably losing market share nationally. It appears that the losers are those who have deficits, and those who either are profitable or have prospects of increasing their market share. Why do I say that? Because most mandatory production quota plans assume an across-the-board reduction at the individual farm level. It ignores whether a region is a deficit region or surplus producing region. It simply says that we're all in this thing together. That has very serious regional implications, as you can appreciate. I think that that's going to be one of the more sticky questions that's going to have to be debated in this whole matter. Regions such as the northeast, the southeast, and California that are either currently

deficit or have prospects of considerable growth in demand could be denied an opportunity to sell into their own market. Northeasterners, for instance, talk about "supplying their own market". They'd be denied this opportunity, unless they were willing to buy back from those who are legislatively granted a share of their market, the right to sell into that market. Lew Mix argues that the Northeast "imported" approximately 15% of its total consumption in 1985. If we were to suffer an 8-10%, or more likely, 25-30% reduction in local supply, we would obviously be more deficient than we are now. If producers in this region wished to increase their production--merely to sell into their own market--they would have to buy back a certain share of the license that legislation granted to people who at the moment do not have their own local market. As I said, the toughest question of all for farmers is perhaps the regional one.

One of the goals that farm policy makers have had for the last umpteen years is to maintain farm numbers at then current levels or, at least, try to smooth the transition that Bob Jacobson described with his numbers. Agriculture Canada reports that, in 1970, there were 135,000 dairy farms in Canada. That's about when they started their quota program. Agriculture Canada reports that, in 1985, there were 45,000 farmers. They apparently lost two-thirds of their farms over 15 years. That is a faster rate than occurred in this country. If we want a program that makes rural areas winners, I guess that we have to look a little deeper and ask, are rural areas going to be winners, if farm numbers are going to tumble at that rate? If there's a way to prevent that from happening, then obviously we should be interested in it.

Second part of the question. The agriculture "industry". This is kind of interesting stuff. I'm going to blame these facts on ERS, the Economic Research Service of USDA. They analyzed the so-called Harkin Bill. I can't vouch for their numbers. There are people in this room a lot smarter than I who can answer that question, but I think that the ERS numbers ask the right questions. The estimate of those advocating something like the Harkin approach are that we'd need something on the order of a 50% reduction in crop acreage. ERS estimates that, in the production sector, this kind of farm policy would result in the loss of over 500,000 jobs, about 20% of total on-farm employment today. It would reduce the farm sector's contribution to GNP by $16 billion, which is currently 23% of the total. In the processing and marketing sector, 1.2 million jobs would be lost and $43 billion in GNP contributed by that sector of the industry would disappear. Finally, in the input sector, they estimate that some 370,000 jobs, or 18% of the current total would be lost and that some $12 billion contributed to GNP by that sector would disappear. Their summary is that on the order of 2.2 million jobs would disappear and $71 billion in GNP would disappear. Now those are quite some changes. Remember, we're compartmentalizing this, we're ignoring farmers for the moment. It's hard to see any winners in those kind of changes. There are more losers than we care to admit.

I would suggest to you that it is those kind of changes--ones that go far beyond the farm--that are going to force this issue outside the realm of agricultural policy. Bob Jacobson asked a question as to whether or not 165,000 dairy farmers would be able to decide this question. I think with these kind of changes you can bet that a lot of other people who have nothing to do with agriculture, at least our view of agriculture, are going to be very interested in these kinds of policy changes. We're talking about economic changes that reach far beyond farming.

There was an article in the Wall Street Journal recently that praised the buyout, which was a striking turn of events for the Wall Street Journal. In the article, Ellen Haas who is acknowledged to be the leader of the consumer groups in Washington, said that the price increases that dairy farmers had achieved under the whole herd buyout were outrageous and unconscionable. Well, I don't know that her words are going to be printable when she sees this kind of policy, if this is the direction we choose.

We're trying to enhance income. Obviously, when you're on the income receiving side, enhancement has no limits. But in the real world, of course, enhancement does have limits. I think we've been successful with the current program, if I can editorialize for just a moment, simply because we've done a pretty good job of striking a balance between farm price enhancement and consumer prices increases. At some point, enhanced prices through government action become taxes--food taxes. Who are the winners and losers here? To eliminate $25 billion in government farm income support (or whatever we're going to spend this year and next) and yet not lose that $25 billion from farm income, food costs will have to rise by $25 billion. There's no free lunch with this kind of program. Farmers may be winners in this trade; are consumers losers? If they're taxpayers, they're losers now, you might argue. Maybe it's an "even-Steven" swap. Taxpayers become winners in this deal (unless we subsidize exports). The same people as consumers, however, are losers. A certain group of consumers--poor people--are big losers because poor people spend a much larger share of their income on food than do middle and upper income people. What we effectively have with $25 billion in tax-funded farm income supports is a kind of hidden food stamp program. If you suddenly make consumers pay higher food costs, put a regressive tax on a certain group of people in society, that is going to create some very big losers.

Synergize these various changes--consumers, farm-level changes, agricultural industry changes--there are going to be winners and losers. I'm not smart enough to tell you who they are. Assuming no other changes in import-export equations, the loss of exports from production quotas will clearly have an effect on our balance of trade. Ask the economists in the room what kind of effect that would have on other economic matters. We seem to be a country in which increasingly more and more of what we produce is less and less competitive. One of the shining stars that we've had, if you ignore the income question for the moment, is agricultural exports. If, as Mr. Jesse suggested, we would essentially reduce them to zero, mandatory production quotas would create very big winners and losers far beyond the agricultural arena. In that sense, the question that we're talking about and trying to figure out amongst ourselves is really just one part of a very large inquiry into what kind of economy and what kind of role the United States is going to play in the global economy of the 21st century. For that reason I would again suggest that this issue goes far beyond what we as farmers may want to do.

Finally, I guess my favorite one (with all due deference to my good friend who's going to speak after me), is the government. There are some interesting winners and losers here. I count the bureaucracy as a huge winner. This is clearly going to be a full employment act, as Ed Jesse suggested, for the economists. This is going to be a great one. We're going to have a considerable bureaucracy to allocate quotas. We're going to have some considerable bureaucracy to guesstimate production and consumption, and all those kinds of planning questions. And undoubtedly we're going to have to have some kind of

bureaucracy to prevent cheating because I can think of a couple of ways to black market all by myself and I suspect with a little help I can think of some more. We had it with the Milk Diversion Program and that was a piece of cake compared to running something like this. We probably had it with the buyout, too.

Politicians. I count politicians as winners in this thing too. Interestingly enough, production quotas involve politics and government far more than the current kind of program. This kind of a program, once given to the political arena, probably will never leave it because it will be used as a way to get at these social and structural questions that the previous speakers have discussed. As I said, one of the reasons we're talking about this is in hopes of somehow directing the structural changes that we see occurring. Both at the individual and regional level, the farm programs will grow largely beyond the control of farmers if we go in this direction. As a result, I'd put, as winners, the bureaucracies and politicians and I'd put, as losers, anyone who's not very adept at manipulating those two groups of people.

Those are the kinds of questions that I came up with in wondering who wins and who loses. What I'm going to do now is go back and dwell a little on the regional question because that's the one that I think is most critical to those of us who live in the Northeast. We saw in the buyout, at least in the New England states, a very large participation, and I think there's a lesson in that. Obviously our land values have held up better than in other parts of the country. That's been very good for farmers, but it also means that it is somewhat difficult to farm in New England. If indeed agriculture has an asset valuation problem and, through this brutal market economy that we have, you see changes occurring in Iowa whereby $3200 per acre land will drop to $1200 per acre and thus will cash flow, a new group of farmers will farm Iowa it and keep the machine going. You don't see that happening in a lot of parts of New England. As a result, I think there are forces far beyond farm policy that are determining a great deal about whether or not we'll have agriculture in New England, maybe including much of New York State, in the 21st century. I think we have to be very careful, therefore, that we look at federal policy as something that doesn't accelerate that process. We're not overwhelmingly a region of small farms and that's probably good in some ways. With the kind of pressure that farmers feel in the Northeast, I think they've grown efficient for very good reasons. When Mr. Jesse looks at these issues of size, the same kinds of questions apply to regions. If we find ourselves in the position where farms in the Northeast have to grow larger in order to survive economically and we will find that we are restricted by a licensing program such as mandatory production quotas would impose, then obviously that's going to have an impact on what can occur. In that sense, agriculture in this region could be a loser, if indeed the program isn't structured properly.

There's been a lot of talk about regional farm programs lately. I'll give you a couple of thoughts. If I were going to write the Harkin Bill, and I were from Iowa, I would have written it exactly the way it was written. It's a masterpiece, if indeed your goal is to save the Midwestern farm. Feed grain costs under that bill would be very different between this region and Wisconsin. As Mr. Jesse pointed out, the bill allows farmers to use any feed they grow on-farm without restriction. It requires everyone else, however, to participate in an acreage reduction program in order to receive the higher prices. The curious thing is that, if you look at my state as opposed to

something like Wisconsin, very few of our dairy farmers can grow any of their feed grain. You're forced to the conclusion that two 50-cow farms--one in Vermont and one in Wisconsin--are therefore going to have very different feed grain costs all of a sudden. And again, unless you're going to repeal the laws of economic gravity, that is going to have an effect over time, regardless of what kind of price you're offering people. I guess I'd change that provision pretty darn quickly because you can see the winners and you can see the losers in that without too much trouble.

If you agree that, we should try to produce for a market, and if you agree that the Northeast is, at least marginally, a deficit market, then I guess another change I would make would be to say that, in markets where there is no deficit, farmers would not be forced to reduce their output. If we have to reduce our production by 10% just to get a handle on a problem that was created by another region, we're losers. If, on the other hand, we are able to produce at 100% of our base and those who have the surplus in their region produce at only 70% of their base, I guess they'd say they were losers. The point is, winner and loser become very relative, very, very relative. That's a provision I'd also obviously change very quickly.

We're going to debate this thing for a long time. I think that's what Bob Jacobson said and I think that's what some other people are going to say. The questions that I've tried to raise are questions that are going to have a tremendous impact on agriculture in the Northeast. They are going to have a tremendous impact on agriculture in the United States! We're not doing a very good job at handling farm income at the moment. Bob Jacobson is exactly right. We have tried to "have our cake and eat it too." We've created hybrid programs, with unclear goals. I think that, as we go through this supply management debate, we're going to have to step back at some point and define our goals. As Jake said, we're going to end up where we're going even if we don't know where we're going. And as you can see from these questions regarding winners and losers, wherever we go, there are going to be winners and losers. Once you get where you're going with mandatory production quotas, there's no turning back. I know of no developed country that has such a program that has figured out a way to get out of it once they're into it. If we in the Northeast have essentially lost a certain share of our current market share through a piece of legislation, and down the road we decide we want it back, we, as a region, regardless of individual farm sizes, states, generations, we as a region are going to be at a disadvantage because we'll have to pay a cost to buy that license back. That's going to have tremendous implications on what agriculture looks like in the 21st century.

THE CASE FOR MANDATORY SUPPLY MANAGEMENT FOR MILK

Ronald D. Knutson[1]

Dairy policy is in disarray. Efforts to bring production back into line with consumption, including both price reductions and voluntary production adjustment programs, have failed. Dairy producers' financial condition continues to deteriorate. Yet a recent study by a noted Washington consulting firm, Economic Perspectives, indicates it would take an all milk wholesale price of less than $8.00 per hundredweight to bring production back into line with consumption. At the same time, an Office of Technology Assessment study indicates that the dairy industry is on the verge of a technological explosion that would not only aggravate the surplus problem, but would also result in major changes in the location of milk production.

Current policies have not been able to bring about orderly adjustment in today's industry. They cannot be expected to cope with future conditions. I am, therefore, resolved that a system of mandatory production controls should be adopted in the dairy industry. After providing a more extensive explanation of why mandatory controls are needed, I will outline the specifics of a production control program and show how it will significantly reduce the monumental adjustment problems facing the dairy industry and restore it to a relative supply-demand balance.

Case for Mandatory Controls

One of the basic premises of marketing management is the requirement that *firms adjust production, not price,* to market needs. Agriculture has never learned that lesson. It has never had the tools to adjust production to market needs. Instead, production goes on regardless of the availability of markets; prices fall; and farmers are driven out of business. When supplies are in excess, agriculture historically adjusts price, thereby forcing changes in production capacity. In the remainder of the business world, excess supplies are a signal to reduce production, not to lower prices. The need to lower price in the business world is an indication of management's failure to adjust capacity to market needs. In agriculture, the need to lower prices in response to excess supplies reflects a failure of government to provide farmers the tools of supply management.

The reasons for supply management in agriculture are more compelling than for other industries. Agricultural prices are inherently more unstable than prices for other consumption goods. The reason for this instability lies in

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[1]The author is a Professor at the Agricultural and Food Policy Center, Texas A&M University. The arguments presented in this paper are for their educational merit in a debate context. Neither the Agricultural and Food Policy Center nor the components of the Texas A&M University System take any position on public policy issues.

the combination of perishability and the relative unresponsiveness of both producers and consumers to price changes. Consumers are unresponsive to reductions in the price because there are few good substitutes and a small proportion of consumer income is spent on individual foods. Producers tend to be unresponsive to price reductions because farm buildings and equipment are specialized for milk production. Therefore, assets tend to be frozen in dairying. In many areas, there are few alternative farming or nonfarm opportunities available.

Surplus production is not unique to dairying. Virtually all agricultural commodities are in surplus. There is little or no hope that milk producers will be attracted to producing a more profitable alternative product. There are few, if any, attractive alternatives--either in agriculture or outside agriculture.

While the general arguments for production control are obvious, there are a number of specific reasons why controls make particular sense in dairying.

- Past attempts to adjust milk production to market needs are replete with a series of policy failures. From 1981 through 1983, dairy legislation was modified annually. Lower price supports failed to reduce production. From 1983 through 1985, biannual policy changes proved that voluntary production control programs do not work. In 1987 there is need for a program alternative that will work--mandatory production controls.

- Major structural change is in store for the dairy industry. In recent years, it has become apparent that larger scale dairy producers have substantial cost advantages over moderate and small size farms (Figure 1). Costs of production fall as farm size increases in both the traditional and large scale farming regions of the West and Southwest. However, costs fall further as farm size increases in the West and Southwest. As a result, the comparative advantage in milk production has shifted to the West (Figure 2). Traditional production areas are no longer the lowest cost regions to produce milk. The result is higher profitability of farms in nontraditional milk producing areas (Figure 3). The trend is clearly toward fewer but larger farms. The result is a need for major adjustments in the scale of milk production in traditional regions of the Upper Midwest and Northeast. Production controls can help to facilitate that adjustment process.

- An array of output increasing technologies are on the verge of being introduced into the milk industry. The result will be not only an explosion in milk production, but also a fluid milk supply that is able to move regionally at considerably less cost. Bovine somatotrophin (BST) can be expected to result in an almost instantaneous 10-15 percent increase in output per cow. In addition, the annual rate of increase in output per cow can be expected to accelerate as embryo transfers, computerized management systems, and feed additives are widely adopted. At the same time, milk will become increasingly mobile, being concentrated by processes such as microfiltration or reverse osmosis and transported longer distances at lower costs. Such change will only tend to accentuate and aggravate the required amount of structural change. Mandatory production controls can provide an orderly transition of resources out of the milk industry.

Figure 1. Cost of Production for Different Size Dairy Farms, by Region, 1982.

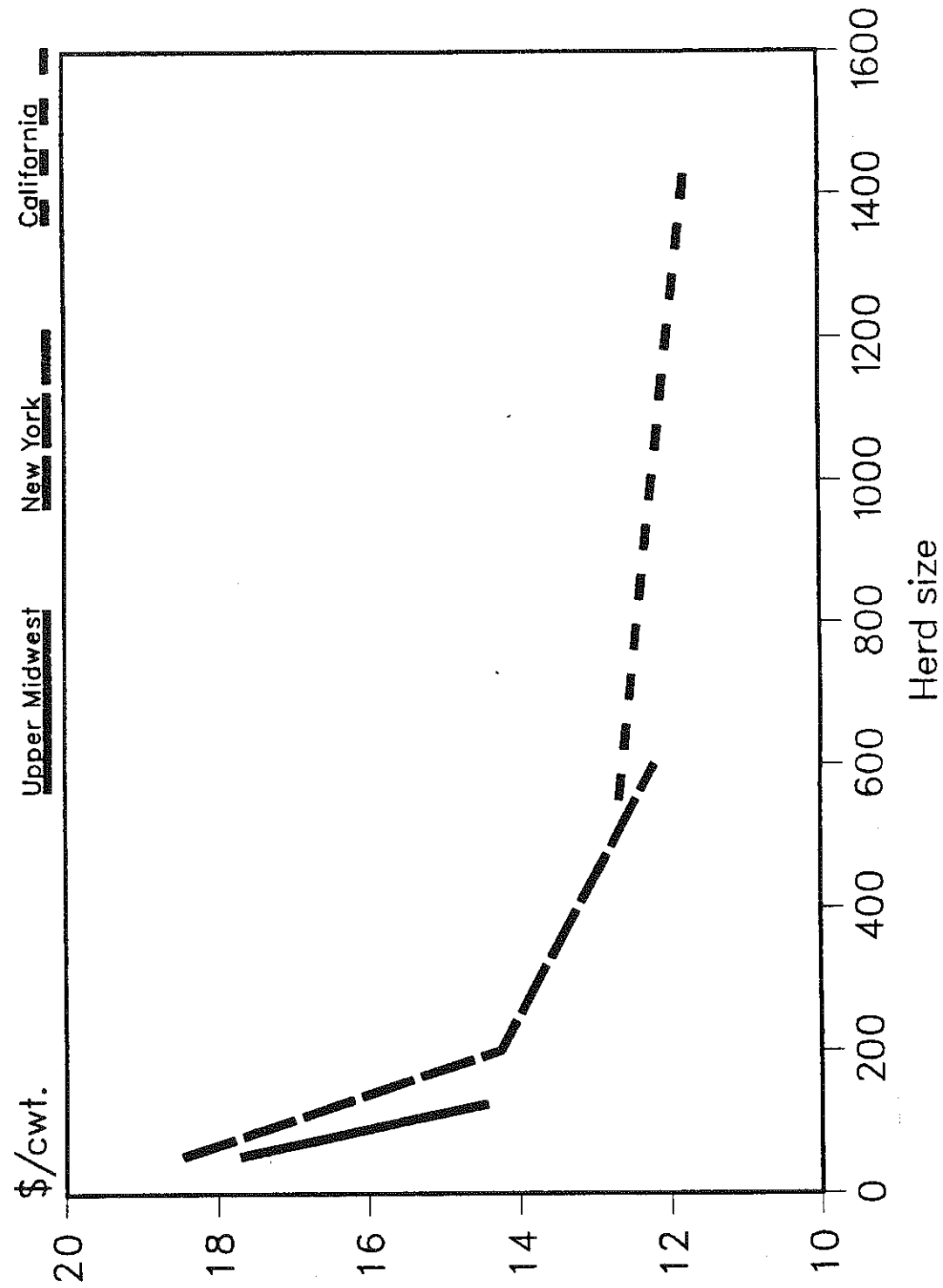
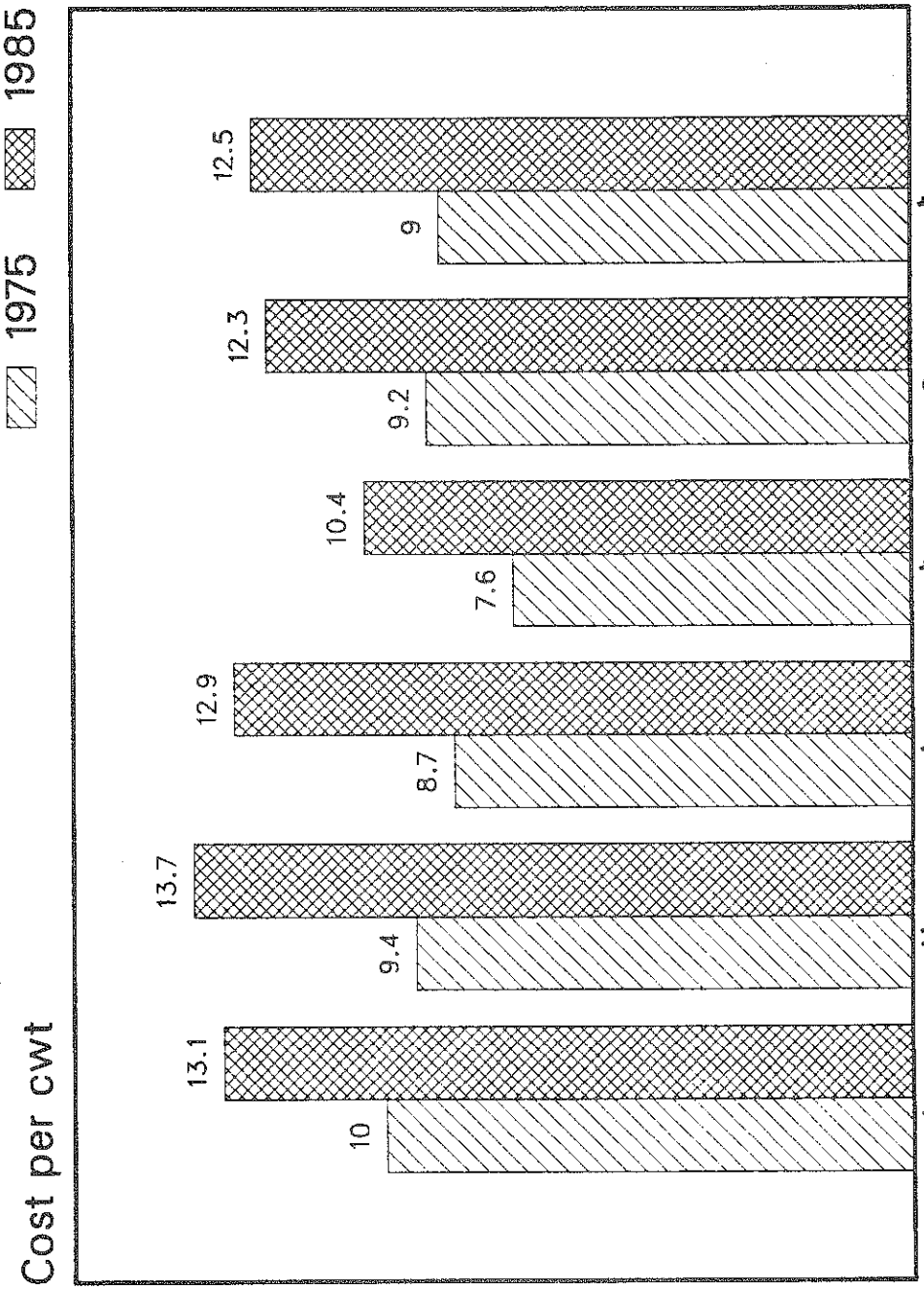
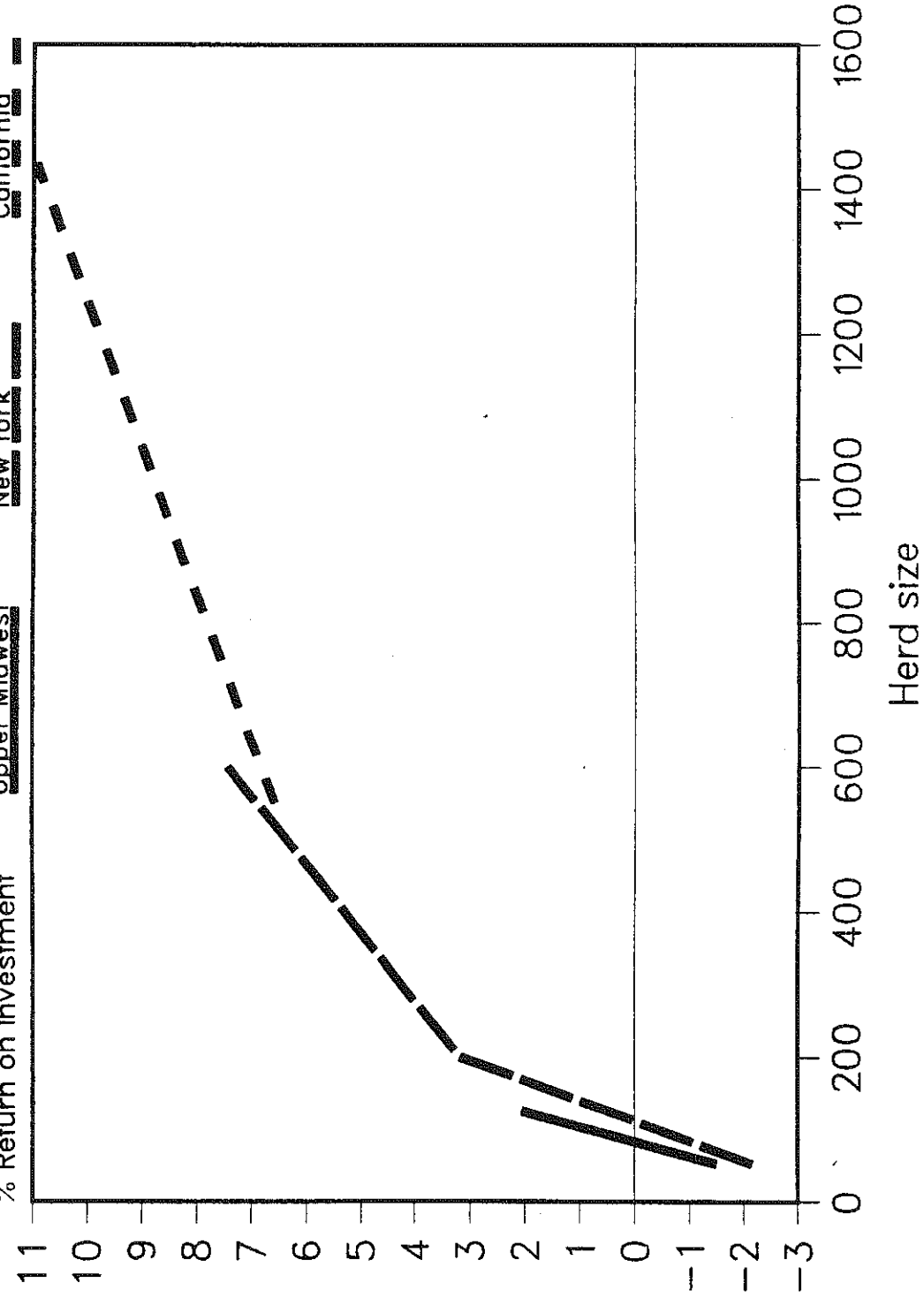


Figure 2. Total Cost of Producing Milk in the U.S. by Region, 1975 and 1985.



Source: USDA

Figure 3. Rate of Return on Dairying by Region and Herd Size.



The net result of these forces is the expectation of increases in milk production that are greatly in excess of market needs. The only question is the amount of the surplus production and, therefore, the magnitude of adjustment required. Economic Perspectives estimates that a continuation of 1985 farm bill policies will result in 13.3 billion pounds of excess production in 1990, without BST (Figure 4). Texas A&M analyses indicate that the excess of production over market needs in 1991 could be about 10 billion pounds without BST and 30 billion pounds with BST (Figure 5). Accompanying the resulting need to reduce milk production, is tremendous pressure for structural change. That is, a much smaller number of dairy farms will be needed. In addition, regional shifts in milk production patterns appear to be inevitable. The only question is whether that excess capacity is going to be driven out by price or by a more orderly process of mandatory controls.

Milk Production Stabilization Plan

Managing milk supplies consistent with market needs provides an opportunity to consolidate current dairy policy tools while making them more effective. The following steps would be taken to accomplish this objective:

- A national milk marketing order would be established covering all milk produced in the United States. Such a national order would manage all pricing and production control programs. Since milk supplies are going to be managed consistent with needs, the ASCS price support and purchase program will no longer be needed. USDA nutrition programs will purchase milk and its products directly as needed.

- A production base will be established for individual producers equal to their average production in 1985. The national production base, therefore, is their 1985 production of 143.7 billion pounds.

- A national marketing quota will be established at the level of expected national consumption of fluid, soft, and hard domestic dairy products.

- Marketing quotas would be established for individual producers by multiplying their production base by the ratio of the national marketing quota divided by the national production base.

- The price for hard products would be allowed to seek its own level with the price for Class III milk being determined on a product formula basis.

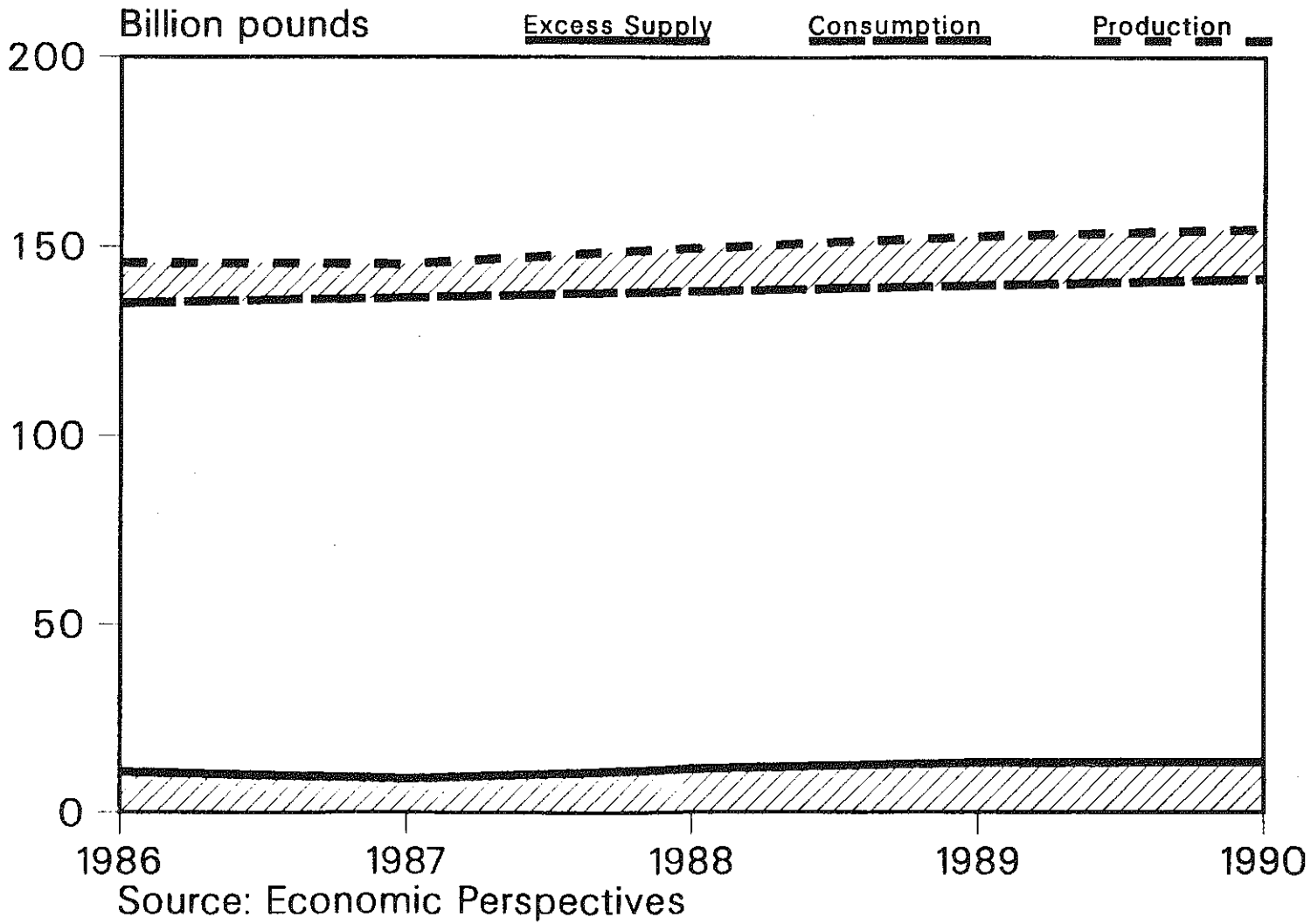
- The national order would be regionalized for pricing purposes with a separate order for manufacturing grade producers.

This plan would solve many of the problems currently faced by the dairy industry. Specifically:

- Milk production would be brought back into line with consumption.

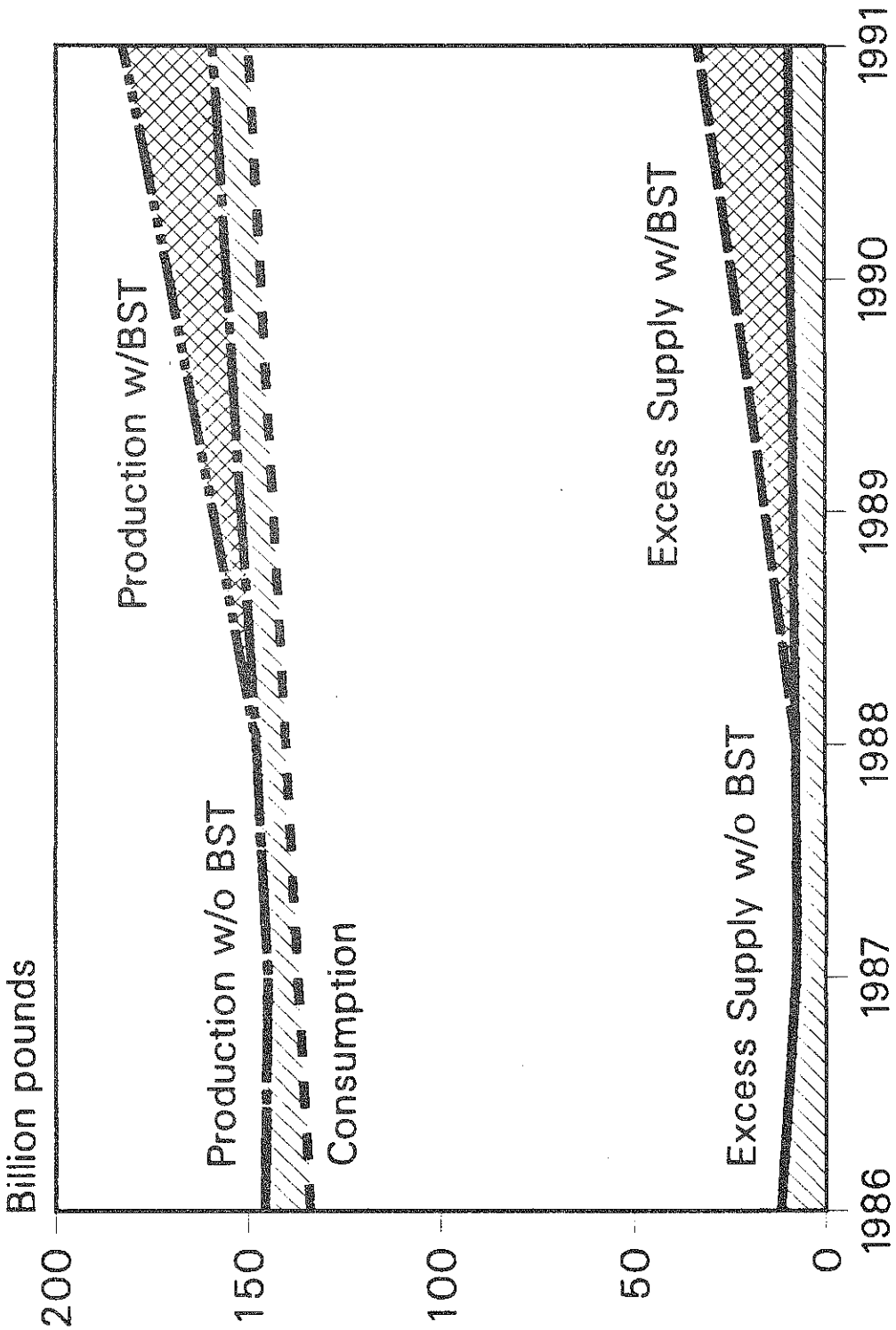
- Government costs would be reduced to tolerable levels--less than $500 million annually.

Figure 4. Projected Milk Supply-Demand Balance Under a Continuation of Current 1985 Farm Bill Policies.



Source: Economic Perspectives

Figure 5. Projected Supply-Demand Balance Under a Continuation of Current Policies With and Without BST.



- Increased production resulting from the technological explosion expected in the 1990s would be effectively curbed, assuring a smoother adjustment without unmanageable surplus stocks.

- Quota values would provide farmers an incentive and reward for exiting milk production. This contrasts directly with the current system which would drive milk producers out of business through low earnings and bankruptcy.

In addition to solving the problems of the milk industry, the Milk Production Stabilization Plan offers several side benefits:

- Two large reservoirs of milk would become regulated. This includes the Grade B production, predominantly located in the Upper Midwest, and the California production. In 1985 regulated milk accounted for 68 percent of the national production. Getting California and Grade B production under federal control should be a central concern of the dairy industry.

- Federal regulation would be consolidated into a single agency of USDA. The current division of administrative labor between ASCS (price supports) and AMS (federal orders) creates friction, inconsistency, and inefficiency in dairy program management. Relying on production controls to support prices eliminates the need for commodity purchase activities (except for nutrition programs).

Concluding Remarks

Current dairy programs are outdated. The challenges facing the industry in the future are going to be greater than in the past. Without major changes, both the price support and federal order programs will fall under the weight of surplus production that accompanies technological change. Only mandatory production controls can effectively withstand the political and economic pressures exerted during these times of rapid change.

THE CASE AGAINST MANDATORY SUPPLY MANAGEMENT FOR MILK

Bernard F. Stanton[1]

The questions of who will make the decisions on supply management and how they will be carried out is central to this conference. The signals that supply was outrunning demand were clear enough five to six years ago. The process of finding effective and acceptable ways of solving that imbalance have been slow, costly, and difficult. Drastic remedies are being proposed. This presentation is intended to help decision makers in the dairy industry think as clearly as possible about the alternatives available and their potential consequences. One of the alternatives available to correct supply-demand imbalances in this country is the imposition of mandatory production and marketing quotas.

At the outset, it may be appropriate to think for a few minutes about why mandatory quotas have not been instituted more often in this country. Most look on the imposition of mandatory limits on quantities sold as a policy of last resort. Why is this so? It is because producers, consumers, taxpayers and government officials have generally viewed this approach to be the least attractive among the various alternatives. Experience has shown it to be restrictive and expensive. Producers, processors, and workers in the industries involved complain about the programs and the inevitable restrictions imposed on those who benefit.

The three major agricultural programs in the U.S. with a substantial history of acreage allotments and production controls are sugar, tobacco and peanuts. It is easy to recognize that these commodities are substantially different in terms of structural characteristics from dairy. The sugar and tobacco programs have evolved over a substantial period of years so that direct government costs are minimal except for administration.

In many respects, the current peanut program should be of particular interest in thinking about what some of the issues might be if the dairy industry opts for mandatory quotas. It incorporates a two-tier price support program with a national poundage quota. The national quota reflects domestic uses in previous years. It is allocated among states in proportion to the previous years' allocations. Individual poundage quotas are established for each farm that had a poundage quota in the previous year. Additional peanuts are defined as those peanuts sold beyond the quota. The support level for quota peanuts in 1986 was $607 per short ton; additional peanuts were supported at $150 per ton. Quotas may only be sold, leased, or transferred within a county or to an operator in a contiguous county within the same state. Many of

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[1]The author is a Professor in the Department of Agricultural Economics at Cornell University. This paper benefitted from the careful criticisms and useful suggestions of O. D. Forker, H. M. Kaiser, and K. L. Robinson. Responsibilities for errors or omissions rest with the author.

the features of this program are likely to be incorporated in any future quota program for another commodity.

Another important source of information about the operation of quota programs is provided by the experience in Canada and the European Community with their respective dairy programs. Many of the comments in this paper are based on the problems they have encountered and the costs that go with their programs. Basic concerns about quota programs that should be recognized at the outset include:

(1) Restrictions on producers and industry to make changes.
(2) Value of quotas add to production costs.
(3) Regional shifts in production are made difficult.
(4) Increased prices will reduce consumer demand.
(5) Stiff penalties for over-quota must be enforced.
(6) Inequity of windfall gains to current producers.
(7) Costs of program are passed to consumers and future producers.
(8) Administration of program in the national interest will be politically difficult.
(9) Once in place the programs will be permanent.

Some of the argument and evidence supporting these points follows.

Arguments Against Quota Program

Limits to Change

A quota program limits the ability of producers and the industry to make desired changes as technology, resources, or market demands change. An operator's freedom to either expand or contract operations is curtailed. To produce more requires the acquisition of additional quotas first; to contract may well require the payment of penalty or the loss of quota without recompense unless it is planned in advance. Thus, to bring a son or daughter into the business involves extra capital, not only for the added cows, land and equipment, but also for the right to produce for the market. In the same manner, assembly and processing decisions will be tied to a less flexible system where innovation may appear less welcome. Thus, the land, labor and capital used in dairy farming will be less mobile, and more resources will be required to obtain the same amount of production. More small and medium-sized farms are likely to continue in dairying without investing in new technology.

Quotas Add to Costs

Once the right to market a certain quantity of milk has been established on some historic base, that right will take on value. The value of this quota will depend on the level at which prices are set and how easy or difficult it is to buy and sell such rights. Expectations about the future profitability of owning a quota will establish the price. And owning these quotas will inevitably add to production costs. For the system to work, the quotas must be transferable--the easier the procedures for transfer, the more efficient the program will be.

Hamm and Nott have recently appraised and compared experience with quotas on dairy farms in Ontario with results for dairy farm account cooperators in Michigan. Their study provides insight about what might be expected in buying and selling quotas on this side of the border even though our market prices will undoubtedly be different. The Ontario program has been well run and widely discussed. They have developed a computerized market exchange which has successfully allowed buyers and sellers of quotas to operate with full access to information and prices. The comparative data in Table 1 are all converted to U.S. dollars.

Table 1. Value of Production Quotas for Milk, Ontario Milk Marketing Board, 1981-85

Year	Quota Prices: Fluid milk per liter[c] (per day)	Quota Prices: Manufacturing milk per liter[d]	Ontario Dairy Farm Account Summary[a]: Market value of quota per farm (U.S. dollar equivalents)[b]	Ontario Dairy Farm Account Summary[a]: Carrying cost of quota per cwt[b]
1981	$ 81	$ 85	$ 53,375	$1.50
1982	137	189	73,182	1.99
1983	185	222	114,987	2.56
1984	172	201	130,018	3.36
1985	204	234	152,915	3.72

a/ Average herd size ranged between 40 and 43 cows per farm between 1981 and 1985.

b/ All values in Table 1 have been converted by Hamm and Nott to U.S. dollars using average annual exchange rates for each year.

c/ Regulated by Ontario Milk Marketing Board, expressed in terms of volume per day.

d/ MSQ (Market Sharing Quota) is allocated nationally; it is valued on an annual basis per liter. For 1981, the published figure is $.234 per liter per year x 365 days or $85.41 to provide comparable figures to those for fluid milk.

Source: Hamm and Nott, "The Canadian Milk Quota System: An Analysis and Comparison to the Michigan and U.S. Dairy Industry," Michigan State University Ag. Econ. Report 489, September 1986, Table 10.

Between 1981 and 1985 the values of quotas for fluid and manufacturing milk have both increased dramatically. As part of the Ontario Dairy Farm Account Summary, an estimate of the value of their two kinds of quotas is calculated as part of the farm asset structure. It amounted to $130,000 (U.S.) in 1984 or more than $3,000 per cow for an average farm with 46 cows. Hamm and Nott estimated the cost of the capital invested in the quotas as a component of total production costs. It increased from $1.50 in 1981 to $3.72 per hundredweight in 1985 and amounted to more than 20 percent of the total the last year.

In this manner, the value of the right to sell milk must be paid for by new entrants to the industry or anyone seeking to expand production. The cost of that right is first paid by the producer but eventually is passed through the marketing system to consumers.

Regional Shifts Made Difficult

Regional shifts in production are hindered or made impossible by most quota systems. When a quota program is initiated, it is natural that current producers want to insure that their share of the market is protected. In the case of tobacco and peanuts in the U.S, quotas could only be transferred initially within the borders of a county in a state. A recent provision has allowed transfers across county borders but not across state lines. However, because these allotments have considerable value, there are still 200,000 tobacco growers and 500,000 holders of allotments in an industry dominated by part-time, small farms. Changes in production technology have been limited to fit this kind of industry.

Historically, major shifts in production have occurred regularly in the United States because this country makes up one of the largest free trading areas in the world. One cannot help but wonder where in this country tobacco would be produced today and how many producers would remain if allotments had been freely transferable for the past 50 years. A quick review of what has happened to regional shifts in milk production in the U.S. since 1960 indicates what might not be allowed to occur if quotas were imposed (Table 2).

Table 2. Milk Production by Region, United States, 1960-1985

State or region	1960	1965	1970	1975	1980	1985
			million pounds			
New York	10,171	11,033	10,452	9,964	10,974	11,746
Northeast	24,50I	25,703	24,224	23,515	26,139	28,727
Lake States	33,037	35,100	32,673	32,257	36,885	41,515
Mountain and Pacific	15,962	15,943	17,180	19,246	23,819	29,923
All other	49,303	47,427	42,885	40,316	41,682	43,502
United States	122,803	124,173	116,962	115,334	128,525	143,667
			percent of total			
New York	8.3	8.9	8.9	8.6	8.5	8.2
Northeast	19.9	20.7	20.7	20.4	20.4	20.0
Lake States	26.9	28.3	27.9	28.0	28.7	28.9
Mountain and Pacific	13.0	12.8	14.7	16.7	18.5	20.8
All other	40.2	38.2	36.7	34.9	32.4	30.3
United States	100.0	100.0	100.0	100.0	100.0	100.0

Source: ERS, USDA, Dairy Situation and Outlook.

From 1960-1985, New York producers have supplied from 8 to 9 percent of the nation's total milk. Production in the Northeast and in the Lake States has held surprisingly steady in terms of national market share. The big shifts have occurred in the rest of the country as market share has shifted to the Mountain and Pacific States. Some of this is a response to demand as population has moved south and west nationally. Part of it has occurred because other farming alternatives or jobs have been more profitable in other regions.

Finding a way to allow shifts in production between regions or states once a quota program is in place has been an intractable problem. Maintaining current market share is a strong cry for any group of local producers. The national market in Canada and the global market in the European Community (EC) is carefully partitioned by provinces and countries. This has been the pattern in the U.S. for tobacco, sugar and peanuts. Over time, this is one of the important reasons why a quota system is likely to lead to less efficient production over a period of years. The political costs of allowing one region to benefit at the expense of another will dominate these decisions.

Prices and Consumer Demand

Any increase in producer prices achieved by quotas will be passed on to consumers. This characteristic is sometimes pointed out as a major advantage of this kind of public program. Direct government costs will be reduced. The major problems with this kind of strategy are the long-run loss of product markets to substitutes and the eventual dissatisfaction of consumers with this method of increasing the incomes of a select group of agricultural producers.

The dairy industry has invested substantial sums in recent years to promote consumption of a wide variety of dairy products. The combination of advertising and lower relative prices has contributed to an upturn in per capita consumption of milk and dairy products since 1982. It is difficult to determine the specific reasons for the increases in consumption, but this swing has been a major bright spot in dairy industry statistics from 1983-86. One persistent danger of any program designed to limit supply and raise producer prices is loss of markets.

An important lesson is provided by the sugar industry in the U.S. Sugar is regularly cited as a classic example of a product with an inelastic demand. Changes in product prices have little or no effect on quantities demanded. Domestic sugar programs in most Western countries have been built around this basic principle. Internal prices to domestic producers are protected. Additional national requirements are met by imports allocated to foreign suppliers paid at world prices. In this setting, domestic producers of high fructose and glucose corn syrups have captured a large share of the commercial market for sugar and sweeteners. In 1975, over 75 percent of all sweeteners came from cane and beet sugar. In 1984, the percentage had fallen to 53 percent of the total as corn syrups provided a high quality, cheaper alternative.

In nearly every case where some kind of monopoly power is exerted to restrict supply and raise prices, incentives are provided to supply these markets with substitutes. Eventually adjustments must be made or the monopoly power is undermined. Efforts by farmer cooperatives to sign up producers and control supply have been tried repeatedly since the 1920's, but the advantages

of staying outside cooperatives have foiled such efforts. If milk producers vote for mandatory controls, careful thought about pricing milk relative to consumer markets will be a necessity.

Enforcement of Penalties for Overproduction

Establishing and enforcing substantial penalty rates for over-quota marketings is crucial. Ontario has a well defined two-tier pricing system. Milk qualifying for the fluid quota is priced about $3.00 U.S. above manufacturing milk (MSQ quota). Over-quota production on a farm in 1985-86 was taxed at a rate of $12.36 per cwt on a base price of $13.36 per cwt. This penalty is substantial and is collected directly from payments to dairymen.

The EC provided for two options when quotas were allocated within countries. One approach was to allocate quotas directly to dairymen. This was the procedure followed in West Germany, the Netherlands and Denmark. Dairymen are assessed penalties at 75 percent of the target price for overproduction. In all of the other countries, quotas were distributed to receiving plants or processors. Over-quota sales were to be assessed at 100 percent of the target price. In practice, "interregional offsetting" was allowed. Over-quota marketings accumulated at any receiving center were assessed at 100 percent of target price but then distributed back among members. This action sometimes cut the tax to 5 percent or less on an individual basis. Needless to say, this has created disharmony among member states and a call by the Commission for an immediate withdrawal of this option. The political pressure to make exceptions for "special cases" is very great. The will and the muscle to impose penalties and collect them is a necessity. The inability of producer boards or government agencies to deal with this issue from the beginning is a major problem.

Windfall Gains to Current Producers

With a program of quotas, historic bases for marketings must be established and then allocated to individual producers. Once in place, these marketing rights will have value, although it will take a few years before market prices for these rights will be well established.

The equity issue of providing a group of current producers with this new asset is one of the problems with this kind of program. It is obviously attractive to the beneficiaries. It will be a cost of production to future producers. Providing this windfall gain to a particular group at the expense of consumers and future producers is one of the less desirable features of a quota program.

Program Costs Passed to Consumers

Consumers are the major losers from a quota program. It is this group that bears most of the costs. Taxpayers, as a group, may actually gain because direct government costs for dairy support operations should be reduced if the program works. Insofar as consumers and taxpayers are simply two ways of describing the general public, this distinction may at first seem to make little difference. In terms of equity, however, there is a distinction. When

consumers of milk and dairy products pay program costs through higher prices, the greater incidence of costs is likely to fall on those with lower incomes. This occurs because low income consumers pay proportionately lower taxes, but this hidden tax through prices makes them pay more of the program costs than if payment came directly from the U.S. treasury. All of the preceding statements about reduced government costs of course assume that a quota system when adopted is run efficiently and that surplus production is held to a minimum.

One potential cost of a national quota program is its potential as a permanent and increasingly inflexible method of determining production and distribution. The stability and continuity which such a system might bring to the industry has to be weighed against the likelihood of higher production costs, lack of competition within the industry and all the problems that so often accompany protected markets. Short-run gains to current producers could soon be lost in a high cost, protected industry.

Difficulties of Administration

Operating a national system of production controls is certainly feasible but has many pitfalls. Establishing the original production bases, allowing for necessary adjustments in these bases, providing for ways to expand or contract them on an annual basis, and determining the procedures by which national production ceilings will be set, are a critical part of making the system work. It sounds straight forward enough to establish a national production ceiling each year that will balance supply against demand. Aggregate consumption does not change that much from year to year and we have good statistics available. But think about the process and the pressures that will be exerted in every direction. There are first, the processors who want their plants to be in full operation; and then the regional groups who believe their producers must not face any cuts in production.

When the EC established quotas in 1984, they struggled with this problem. Production in 1981 plus one percent was used as the base. This global total was over 99 million metric tons and a 4 percent reduction from 1983 marketings. The only problem was that utilization within the Community is about 85 million metric tons and the commercial export market cannot begin to take up this kind of difference. In November 1985, the Commission proposed to the Council of Ministers that quotas be reduced immediately by 3 percent. The Council chose to reduce the level by 2 percent starting in 1987 with no change before that time. Getting EC production into balance with consumption looks like a long, slow, expensive process even with quotas.

It is easy to say that the EC's initial problems in getting quotas to balance supply with demand does not apply to the U.S. because we are one country with greater central authority in government. Yet, we cannot overlook the strong regional differences among producer groups in this country and their historic ability to disagree rather than work together. It is likely the initial years of a national program here would be filled with similar kinds of problems that the EC is facing.

The mechanics of establishing prices for two or three major classes of milk will not be as straight forward as implied. Integrating the current system of state and federal orders into a new managed system will take time,

patience and considerable skill. The steady pressure for higher producer prices and making the allocated quotas as large as possible will be tremendous. The ability to have national interest prevail over regional advantage will be tough for producer boards to provide.

Permanence of Programs

Once a quota program has been established, it is difficult to change or dismantle. A protected industry, like sugar, is difficult to close down because vested interests are so strong. Too many people at each stage in the production process plus the program administrators depend on the program for their livelihood. Thus, each program has a continuing life of its own. Program costs, disguised in the form of increased consumer prices, get less attention than direct government outlays for subsidies. Once in place, a quota program is likely to be with us a long time.

Summary

In the final analysis, a quota program must be judged on whether the expected gains will outweigh its likely costs. Will a mandatory program provide more satisfactory results for producers and people at levels in the dairy industry than a combination of regional and state market orders, a price support program for manufactured products, and free market decisions on other issues? Can the regional differences within the dairy industry be brought into some semblance of agreement and cooperation? What is the route to supply and market discipline that is required?

Both the European Community and North America are producing more dairy products than they can consume internally or export to others who have money to buy. Dumping surplus dairy products on the world market is not a solution to excess supply. Clear signals must be provided to dairymen about the market for which they produce. The question is how best to do it.

There are important problems to be faced if mandatory quotas are voted in by producers:

(1) Producer and industry freedom to respond to changes of all kinds will be reduced.
(2) Quotas will add to production costs.
(3) Regional shifts in production in the future will be made more difficult.
(4) Increased consumer prices to pay for the program will reduce consumption.
(5) The will to enforce penalties on over-quota marketings must be provided.
(6) Administrators of the program and industry boards must have enough authority to make the system work--to keep supply in balance with demand.
(7) Additions to consumers costs will likely exceed taxpayer costs when compared with the current market order program if flexibility in setting price support levels is provided.

From 1960-1980, the market order system, combined with a flexible price support system, effectively balanced supply with demand. An inflexible level of supports has been shown to cause problems in the 1980's. Can we expect the present leadership in the dairy industry to set national quotas realistically and build flexibility into a new managed system? If so, why not allow the present structure or a two price system to allocate supplies without creating the burden of a system of quotas and all that goes with it?

THE POLITICAL CLIMATE FOR DAIRY PROGRAMS

James Jeffords[1]

I want to talk reality with you today. My goal is to let you know as best I can from my own observations and beliefs what the political realities are regarding future dairy legislation.

First of all, I'd like to give a little background on dairy policy so that we might all better understand how we got where we are.

For the last three to five years, dairy policy has really been dictated more by the deficit and deficit reduction than it probably has by farm policy. This is true with the other farm commodities as well, but more so with dairy. Thus, we had a thing called an assessment arrive on the scene in 1981. I had nothing to do with developing these assessments. As a matter of fact, I was against it. Unfortunately, others didn't let me on the conference committee that year so I absolutely have my hands clean. But that was done for only one reason, to reduce the cost of the program. It had other uses later on which were defensible, but at that time it was purely for deficit reduction. I think that's important to keep in mind because often that aspect distorts what we end up with dairy policy.

I want to emphasize deficit reduction and the part it has played in dairy legislation before I go on to the present program and what the political climate is for changes, we are going into our worst deficit year yet in FY '88. You think this year was bad as far as deficits go or pressures on programs, wait until next year. The President had three goals when he came into office. The first was to increase defense spending, the second was to cut taxes, and the third was to shift programs (including agricultural programs) either back to the private sector or to the states. He got one and two, and as a result of that we have a $200 billion deficit. He still wants me to impose number three. Whether he can do that or not, time will tell. We've had a shift as you know of power from Republicans to Democrats in the Senate which always can lead to game playing, but there's certainly going to be a lot of interplay. The President himself believes very strongly that farm programs should be handled in the market system, out in the private sector. We've seen that in all the proposals by the Administration, although they've been modified as time has gone by. So you can keep that in mind as background because its an important thing to realize as we go into the next two years.

Let me talk specifically about how the Administration feels about a mandatory milk quota program. The President is emotional about quota programs. And, when it comes to dairy, the President raises right up in his chair especially when you mention the quota program. Why? Because when he was governor

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[1]The author is a member of the U.S. House of Representatives from Vermont. The editor has edited the Congressman's oral presentation from a tape recording into written form.

of California, the California quota program was adopted and that's one of the few things he says he ever regretted in his life. That program is a mess, it has created all sorts of problems and the President is adamant at not seeing another one come about. So those of us that advocate dairy programs have to keep that in mind, especially when we're talking with the White House.

With this background, let's go on and talk about where we are right now and how we got to the 1985 Act. Incidentally, any who have followed my legislative actions, know that I've been involved with three major programs. I was sort of the prime negotiator of the promotion program, the milk diversion program and the father (I'm the only one in the country that continuously accepts being the father) of the whole herd buyout program. While there are some individuals in Congress that sometimes take credit for some of these programs, I'm the only one that has done it continuously because I can't help it. I introduced them, put them in form of legislation and lobbied them into being.

There has been a feeling, by some, that the dairy provisions of the 1985 Act are not working. Now before I go into that, let's take a look at what the alternatives were. The quota program, just for a little background, was almost exactly what is in the "Save the Family Farm" bill. This bill was proposed on the House floor as an amendment to the 1985 Act and it only received 35 votes. Keep that in mind as we take a look at political reality.

What were the other alternatives we had? The Administration wanted a dollar cut in the support price immediately and followed by a 50-cent price cut thereafter. The Senate came up with a dollar price support cut, strangely, right after the 1986 election. They wanted a dollar price support cut on January 1, 1987 and 50 cents in periods thereafter. These were the alternatives we were faced with in the House knowing that everybody else (the Senate and the Administration) wanted price support cuts. We have had, as I said, two really successful programs if you look at their impacts on deficit reduction and milk surplus reduction. All of us that supported the diversion program had to swear in blood that we would not vote to continue it because of political opposition to it. We had to come up with another program, one that countered some of the problems inherent with the Milk Diversion Program.

To start with, the diversion program was too short. In addition, there are a number of other reasons why it wouldn't work. So somebody out in California came up with the idea that if our problem is too many cows, why don't we shoot the cows. And that seemed to be preferable to shooting the farmers, so we decided that we would take a look at that program and we ended up with the Dairy Termination Program. I don't like that name so I will call it the whole herd buyout because I think it sounds a little bit better. People say, as you know, that things are still a disaster. I understand. This is an emotional subject. I've been talking with my farmers at home and I've had some shouting matches back and forth and I understand its a difficult time. We have a number of people who are right on the edge of going off the brink into financial disaster. But the reason we put the buyout program into effect was as an alternative to price support cuts. Also, recognizing the facts and figures we were given, it appeared that it would take a price drop to the eleven-dollar range in order to have a supply-demand balance. In other words, farms would start going out of business and production would start going down without the whole herd buyout at this level. Taking that piece of information, it seemed

logical that we could have a program that would rid us of about 12 billion pounds of milk in a way that the cows would not go from one farm to the other. So if we could get rid of the cows then we could get down to the point where we could stabilize a better price (better than the price cut alternative)--somewhere in the eleven to twelve dollar range, at the same time keeping at least a large majority of farmers in business and take the surplus milk out. Things would stabilize and hopefully we could go from there without any serious regional dislocations.

Is it working? Most of the comments we've seen have been kind of negative. But I ask myself how come its not working? Isn't the price farmers receive in the New York and Boston markets this month 44 and 42 cents per hundredweight more than they got a year ago? How come its not working if for the first time in recent memory we're selling nonfat dry milk instead of buying it (at least we were last month)? If it is not working, then why for the first time in history is cheese and butter flowing from the West to the East Coast. So if its not working, I have to ask myself why? And these phenomena are occurring with only 54% of the cows terminated under the whole herd buyout program. With so much more to go, why are we so down on the program? And I can tell you I've got a lot of farmers who are down on it. I have to review their concerns, especially since I feel responsible for the program, and I have to have some reasons to respond to you.

In responding, I would argue that the three programs previously discussed have worked. The promotion program is working well, at least the experts agree that consumption has certainly gone up. You might argue it wasn't the promotion program that has caused this, but it's certainly been a part of the reason for increases in consumption. The diversion program worked, saved a billion dollars, and got supply under control. And now we've got the buyout program which, according to Hoard's Dairyman, is going to save the taxpayers $6 billion and is going to pretty well straighten the market out.

So I'm not as down on it as some other people are. Also, another thing which is going on that we have to keep in mind is the tax bill's effect on some of those problems that we've seen out in Arizona and California. They may diminish. In the Northeast, we ought to get together and work on getting over-order pricing through RCMA or whatever device we have to achieve higher prices. Right now in this country the average above-over price in the United States is 80 cents per hundredweight. In my area (Vermont) some farmers are getting 25 cents, while others are getting 20 cents. But they're not getting that 80 cents above-order price, which would not put us well over a dollar above what we were getting last year. So I can't be completely down and say that the present program is not working. One of the things I don't like is the triggered price support cuts beginning in 1988 and I think we should try and do something about those. Also, there are options in the 1985 Act for either a milk diversion program or another whole herd buyout in case we get into another surplus situation. I would much prefer requiring these voluntary supply management programs to another price cut to achieve surplus reduction; although I don't believe we should look to these programs in the immediate future. We should eliminate the 1988 price support cut and let matters settle down first.

Let me talk a little about the political climate in Congress. First of all, as I said, we have an Administration which is going to be death on the Harkin bill. It'll be death on any mandatory quota program. So in order to

talk about realities to you I have to talk about overriding a veto. And I don't think there's anybody that's been dealing with the situation that would not agree with me on that. I'm sure that unless this is wrapped up in some big bill, it'll be vetoed. That means you've got to get two-thirds of the Senate and two-thirds of the House to override the veto for passage.

I don't know what the cost of the Harkin bill is, but I do know that it's going to raise food stamp costs between $1-$2 billion. I don't know what the export subsidies would be, but it's going to be substantially increased unless you just do no exporting, as has been suggested. So you have a real problem there. Another problem which has come about because of the pressure and because of the rather large sums of money which are involved in agriculture programs now is the fact that the urban rebellion is growing. You may have read about it. There are urban Congressmen who say, "hey, why are we spending all this money on agriculture?" When you look at the net farm income in this country ($46 billion), half of that's coming from the treasury. This has got many urban congressmen upset. My response is sure that's a lot of money, but when you spread it out it isn't. But urban people look at it in terms of billions of dollars and you've got to answer that question.

You've got to also remember that we have a shift in the Senate, which may lead us to some game playing and that's kind of on the positive side, but could be negative overall. It's quite possible that the Democrats will get their act together and say the elections in 1988 are coming up and let's stuff the old Harkin bill through and make the President veto it and then hopefully we won't override the veto and we won't have to be faced with the realities of the bill. I'm serious about this because I hear it all the time. That may happen, so its quite conceivable that you will get the bill to flow through the House and Senate, but I'll guarantee that it'll never be enacted into law--not as it is right now.

Let's take a look at whether it is possible to have this kind of a bill. It's a great political gimmick, great for getting farm votes and at the same time knowing its political chances are slim at best. The bill will be hit from the right, and hit from those that don't want a government program that will say this is Socialism and on the verge of Communism. On the left you're going to get hit from consumer groups. Consumer advocates like Ms. Haas will likely align with urban politicians who will be attacking from the left. You've got to remember that normally when we put these programs together the way we take care of the urban side of the ledger is that we tie it with food stamps. So you have a bill that's on the House floor that's the farm bill and it has food stamps so you have something for the urban food stamp people and you have something for the farmers and you get everybody to agree to pass it. If we open the bill up in the next two years you don't have that. All you've got is a farm bill sitting out there for people to pick at. While I agree that we have to examine these programs, we have to be careful or we could end up doing a great disservice to the farmers.

Why would it be a disservice to dairy farmers to raise hopes for quotas? The problem right now is you've got people racing for base. They say "ah, we will get a quota program, so let's go out and add cows, borrow money, and increase production and then, when the quota program comes, we'll have a higher base and we'll live happily ever after". But the problem is, as I see it, you've borrowed money, you've put on cows, you've increased the base and what

happens? Under the bill, the price goes down 50 cents, maybe a dollar, for two years. So what do you end up doing? You end up loading yourself with more debt and with less income. That's not the way anybody would like to see it go. I can't, as a responsible leader, go around advocating a quota program because it just isn't going to happen.

What can we do? I think there are some options that we can take a look at and although one of them has already been condemned, I would say that I'm looking from within political realities. First of all, if there are some problems with the present bill, let's fix it. And certainly I would like to get rid of current and future assessments. We're past the point where there is a lot of money to be saved by assessments. Secondly, I would remove the price support reductions that would be required under the bill. We have more farms in our state going out of business by virtue of the auction block than we had by the whole herd buyout. And third, I would make future supply management programs voluntary. Give farmers an option, either the diversion program or another modified smaller whole herd buyout, keyed to surplus regions, to get rid of additional surplus. As we look ahead to BST and other technologies that will tremendously increase production, I think that voluntary programs are the tool which will get us out of that mess.

Now suppose that the crop portion of the Harkin bill passes, but the dairy doesn't, which is the only remotely likely scenario (than a milk quota program). Then, it's more likely politically to think in terms of something like a target price and deficiency payment program for dairy. Why do I say that? Because the previous Secretary of Agriculture, and I believe this one, are friendly towards the concept. And if you remember, the Administration proposed such a program at one point. They said one way to ease out of the support program is to go to a target price system. You can modify that all over the place, you can still have your support program or not, but I think that's one thing we ought to take a look at. And also your Wisconsin and Minnesota politicians have generated some support for this concept, but I just want to reemphasize again that in my humble opinion the likelihood of getting a quota program through before 1990 is really zero; I don't see any hope for it. So for people to plan on the basis that quotas are going to be in effect in the next year or two is very counterproductive.

THE DRIVING FORCES AFFECTING DAIRY POLICY

Ronald Allbee[1]

My assignment today is to talk about the political driving forces affecting future dairy legislation. To do this, I want to focus on what the recent results of the national election means to dairy policy. I would also like to mention a few political considerations along the way. As some of you know, the fact that the Democrats now control the Senate means that Senator Leahy will be the new Chairman of the Senate Agriculture Committee.

I don't think anyone expected what happened to happen. In the last few days Senator Leahy's office has received several calls, the news has reported it. The Japanese have called and asked us what our position on rice was. We responded that we weren't going to have a controlled wild rice. The Australians have called us both from New York and the Embassy and asked us what our position was on products via their country. It seems that everybody is calling the Senator's office and asking what position was he going to take. Therefore, at the outset I'd like to let you know that whatever I say today should not be construed as a position unless I dictate that it's a position. I'm an advisor; I don't take the position, it's up to the Senator or the Congressman to take the positions I advise.

If we had this discussion not today, but two years ago, the discussion would have been on what does the Administration's free market approach, what does their philosophy, mean to the dairy industry. It meant quite simply the gradual termination of the dairy price support program. If we can look back but a mere short two years ago, Secretary Block came up to the Hill with a farm bill, a farm bill which was meant to put U.S. agriculture on a free market basis and I think, at least in the Senate, it was referred to as dead on departure. It wasn't even dead on arrival! So I think I have to argue, and I know Congressman Jeffords just mentioned, that the Administration is still fully in support of a free market approach to policy. I'm an economist, so I have nothing against the free market. But I think you have to define what you mean by free market. I think the Administration's definition meant <u>total</u> relaxation and <u>total</u> reduction of government programs for agriculture. I think we've had that debate. I would argue that that debate has long since passed. It doesn't mean, however, that there aren't going to be efforts to have more market control for agriculture.

My prediction November 3rd was that at best, the Senate would return the Democrats by a 51-49 majority, <u>at best</u>. I woke up the next morning and it was 55-45 and I don't know anyone who claims to have made that prediction. Last year it was 47-53, so it is a majority. Suddenly Senator Leahy, who I work for, became chairman of the Senate Agriculture Committee.

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[1]The author is agricultural advisor to U.S. Senator Patrick J. Leahy. The editor has edited this paper from a tape recording of Mr. Allbee's presentation.

You might say so what. First of all, Vermont now certainly has a strong voice with Congressman Jeffords on the House side and Senator Leahy on the Senate side. We do work together and we remind people that we don't work separate on agriculture issues. With these two individuals working together, the Northeast (not just Vermont) industry will be better off. You say so what, well I'd just like to point a couple things out about how the Senate worked last year to let you know that it does make a difference. First, the issue of supply control, provisions of the Harkin bill, and at that point it was the Harkin amendment, came up in the Senate. I think its fair to say that Chairman Helms never let a hearing occur on that proposal. We were criticized. Senator Leahy was criticized because we would not introduce the so-called National Milk proposal in the Senate Agriculture Committee. Remember, that proposal contained a continuation of the diversion program. We would not do it for some very simple reasons. We knew that if we introduced it in the Senate Agriculture Committee that (1) we didn't have the votes nor the coalition that would support it, and (2) if we had a no vote on that proposal and went forward we would have a record and certainly we'd probably be unable to strike a deal between the House and the Senate that would be favorable to the dairy industry. So it was never proposed and we never discussed it in the Senate hearing committee because we were not in majority.

I'd like to point out something else that happened just to give you an example of how the majority rule works. At 5:00 one afternoon the Chairman, Mr. Helms, and Senator Dole, indicated that dairy would come up at 9:00 the next morning, and that they would not consider dairy that evening, that they would consider other commodities. The Senator walked out of the room and about 5:05 Senator Helms indicated they would start considering dairy. He could do that because he was chairman and he sets the agenda. I can promise you on the Senator's behalf that that will not happen this next year when he's chairman.

I would argue that the choices facing you are no different than they've been before. Price cut, supply control--those are the choices. The difference is that in the last four or five years we've dabbled. What do I mean dabbled? Well, we've had the diversion program, certainly. That's supply control. We've had price cuts, certainly, as we do now, that's included in the bill. And with the whole herd buyout program we certainly have a form of supply control. I think they both work, although the jury may still be out on the buyout program. But we've never been able to put in place any longer term alternatives for the industry, i.e., we've dabbled.

I would argue that supply control is not a bad word, we have it in agriculture; we have a long, long history of having supply control in many commodities. So it isn't anything new. I think what we're going to be arguing is the degree of supply control, to the extent of how it intermeshes with the market forces. I think the dairy industry has an important decision to make. I think they'd better decide quickly where they want to go. One thing I observed last year in Washington was that the administration wasn't particularly fond of the dairy industry. I can't fully explain it, but I know that they were out to make some major cuts in the price support program. And I know that when the Senator beat them back on the Senate floor they wanted to come back at us and try to beat us again. And they didn't do it. So I would say that its difficult--whatever you do, you're going to have to have a coalition; you're going to have to be included with other commodities.

Now the question might come up--what's Senator Leahy's position on the Harkin bill? Well, I knew it might come up so I'll mention it. It reminds me of a local politician in Vermont who went out to a group like this and it was a very controversial subject that he was asked a question on. The audience asked "what's your position on the subject?" He looked at the audience and said "I've thought a great deal about it, and I know each of you personally. Half of you have told me that you support the proposal, and the other half have told me that you're against it. I will do what you want me to do of course!" Anyway, we did have some pressure to support the Harkin bill right before the election. A group in Vermont indicated to us that Senator Leahy should co-sponsor the bill. We told them that we wouldn't do that, that we wanted to have hearings. He brought Senator Harkin to Vermont to meet with some farmers to discuss his proposal and he came and he was very convinced that would provide a solution to agriculture.

The Senator has promised two things. First, he's going to have hearings throughout the country, to listen to the farmers. And second, he will not put his name on any proposal until after those hearings occur to find out where you, the farmers, are. I think that is an indication that politicians don't get too far in front of constituents. If constituents don't support a proposal they certainly aren't going to introduce it.

We have several things to do. One, we have to increase agricultural trade. Two, we have to reduce farm program costs. And three, we have to stabilize farms and farm incomes. It sounds simple, but we know it isn't. I guess it was President Johnson that was asked what his farm policy was going to be and he said "spend, spend, spend." But I don't think we have that alternative with Gramm-Rudman and the budget deficit. So there will be some driving forces: the budget deficit, agriculture trade, farm incomes. We're going to have to act very quickly. You people are going to have to decide whether you want some changes, and you better strike when you have two people who are in a position that can help you, and they are there.

One final point worth mentioning is that when dairy is brought up, dairy will not go it alone. Obviously the other commodities will be a driving force. But if you expect that because Senator Leahy is in a key position now, that you're going to suddenly come in and push a dairy bill through absent of the commodities. I doubt that that's going to happen because dairy is under the gun from some other quarters. Furthermore, it will continue to be under the gun from some other quarters.