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Testimony to the National Commission on Dairy Policy
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WITHDRAWN
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All right, Dr. Hamm, Michigan State University.

Thank you. It has been a long time since this morning. I think you will agree, and I will try to be as short as possible. My name is Larry Hamm, Associate Professor of Agricultural Economics at Michigan State University, currently doing the dairy policy and marketing work at Michigan State.

I have been seeting back and trying to put some of this stuff in perspective. First, I want to compliment the Commission for the level of questions and the interest shown to those people who appeared today and expressed themselves. I am very impressed so far of the Commission's work. Second, I do not envy trying to bring order to the kinds of comments that are going on all over the landscape. I will try to help today. I know that you have had many other days like this.

Three or four things popped into my head and I would like to throw them out for your consideration as a way of helping me try to understand this industry.

One fundamental question will be government versus no government. I do not think that is really a debatable issue. In the dairy sector there has been three historic roles of government. Government has been involved in dairy to provide safe markets, orderly markets, and fair markets. The safety being, of course, the safety in health issues; the orderly issue primarily embodied in the order system and order regulations; and the fair market I guess is basically the charge of this Commission. Of course you can debate what is fair, but it seems to me that there are two issues of fairness. One is the level of income to dairy farmers vis-a-vis other farmers and the general level of society. The second is from some social dimension of what do you want the industry to look like and

what can the industry look like. So there has always been the role of government and it will always be in the dairy industry. The question is, how do you define the role of fairness? If you are going to deal with income, a couple things really hit me. First and foremost is one piece of information an economist absolutely needs is the elasticity of demand. Elasticity is an economic term which helps explain what happens to farmers' incomes when prices change. One general thrust or policy option is market oriented policies which use prices as the primary adjustment mechanism. If in fact the markets are very inelastic not only do you get massive income adjustments to the dairy sector on the down side, you also do not get the adjustments, the spiraling effect on consumption on the up side.

As a professional economist the elasticities we have been using are vastly outdated. I heard somewhere that the Commission is looking for some help on, what has happened to the structure of the dairy product markets. The issues of fluid versus cheese versus the new products we heard about this morning may indicate that the fundamental market elasticities changed. Deciding the policy without that piece of information will be difficult. I don't know how to get it between now and next March.

We have had empirical observations in the last three years that as prices have declined we have had tremendous income adjustments in the dairy sector. As a result you had the response of increasing production to maintain cash flow. That is direct empirical evidence that there appears to be some basic inelasticity remaining in dairy industry markets.

The second thing under the fairness issues is something we touched on just barely this morning; i.e. that the structure of dairy farming is undergoing some fundamental regional shifts. Much of this regional shift is market driven. We cannot overlook that. There is a sizable portion of the population that likes to live in warm and travel two weeks to the cold, rather than live in the cold and travel two weeks to the warm. Changing the location people work and live means that you are going to get a natural shift in the location of the production of dairy products.

That is a natural economic phenomenon, but we do have problems on the dairy policy side. As Mr. Conover said this morning, trying to support farm incomes through a purchase program which then has to go through the objective functions of other people like plant managers and state regulators, causes unforeseen consequences.

We have, I think, an issue that must be addressed. Is the current price support system operated and managed within a system where it fosters increased production which exacerbates these regional shifts?

I guess to summarize how I see regionalism. The state of California generally admits that they would like to have all the milk consumed in that state produced on that side of the Rockies. As they do, there is a lot of milk that has been shipped from the Midwest, primarily the Upper Midwest into California. As that production increases there the structural change, the adjustment in the dairy industry, is being borne and shifted to the Upper Midwest, primarily Wisconsin and Minnesota.

I did a little back of the envelope calculation that just the increase in cheese production in California alone in the last two years has probably displaced 105,000 Wisconsin cows. So as a result you will get that part of the country looking for mechanisms to try to keep from bearing the structural adjustment. We are beginning to see calls for changing the federal orders, primarily the reconstitution issue, and the revamping of the orders. Calls for multiple base point pricing systems and the whole series of other issues are logical responses. I think this is partially a response to how the support prices operate through California's state marketing order system.

Regional stress will continue and undercut all the policy deliberations and issues in dairy. This includes not only fair dairy market, but the orderly market and perhaps even may be seen in safe market issues.

Finally my last point is that the commission is going to have to answer the question, "Is dairy different?" Is the dairy sector sufficiently different to require a separate kind of policy that may not be in harmony with the rest of farm policy direction.

Of course, I do not want to get into a philosophical debate or anything like that, but I think that basically hits right at the heart of most policy debates. Those who maintain that dairy is different because it is a domestic industry that has some unique products and product elasticities.

But again I want to compliment you in terms of the hearing and the witnesses that were here, and I wish you the of luck.

MR. LAURI: All right, thank you Dr. Hamm.

Any questions from the commissioners?

Mike Horner.

MR. HORNER: Dr. Hamm, on the supply management side, what are we to do about our surplus; from an economist's side would you recommend that the surplus, if we ended up with a program of supply management, should that be shared with all regions of the country, including those that are in a deficit production?

MR. HAMM: Okay, I will differentiate between supply management and supply control. Supply management has mostly voluntary sanctions. We won't get into the ways to handle the voluntary programs, however, I think any policy is going to have to recognize these fundamental regional shifts.

So if you mean sharing, yes, there is going to have to be a sharing. The argument I could make is that there might have to be regional policies if you were going to have that. Recognizing that as I think the evidence comes in there are some fundamentally different production, farm management technologies, and size operations. As a result one has to recognize that managing the output from fundamentally different kinds of business enterprises will require different kinds of programs. I view supply management as an attempt to maintain supply and demand in a balance that is consistent with the market and with the income goals that you set for the industry. If you want to balance the market you are going to have to really look at where the markets are, and there may have to be some adjustments in the implementation of the supply management program.

MR. HORNER: Do you have an opinion on our trigger point, on the billions of pounds for government use, do you have any opinion on that?

MR. HAMM: Yes, I have an opinion on it. I do not think it is necessarily that far out of line. There is a question on inventory holding patterns. There was some observation that many dairy economists made that when the government has the inventory function the private sector does use the government for inventory management. I am not too worried about the trigger level.

I guess one of the concerns I have as an economist and I am not making outlook prediction, is that how does one use a trigger unless you use actual purchases. I am concerned about using anticipated purchases versus actual. I guess I am not as concerned about the number that you pick as I am knowing about the methodology that is used to make those determinations. I am much more concerned about that.

MR. HORNER: But you know I, as a dairy producer, it hits me square in the back pocket. That is why I keep asking the question, and I am getting answers all over the board, and if this was four billion pounds we would be in a trigger where we would get a 20 percent increase rather than a two, and this kind of thing, or I mean six billion pounds. So it works both ways, but by the same token it has a direct effect on what the secretary will do, and I know it is opinion but it is all over the board.

DR. HAMM: Yes. The level. I am not that concerned about five billion.

MR. LAURI: Dick Shade.

MR. SHADE: Dr. Hamm, we have seen the so-called voluntary program in the feed grain program, and I heard one central Illinois farmer say that prior to the '85 farm bill, speaking of farm programs he says, "Well, I sure would like to be in the program but I don't have any poor ground," and so I guess we have to admit the high ground, the sandy ground, and the wet ground goes into the feed grain and is set aside.

We recently saw some ground around Nassau County down in Georgia wouldn't hardly qualify for setting aside, but be that as it may.

Well, anyway then we look at a dairy where we have mainly a domestic market and we can work with pounds versus feed grain in bushels, do you think we would have a better chance to work an effective voluntary program in the dairy sector versus what we have seen in the feed grain?

DR. HAMM: Well, if you are managing markets as opposed to one of the components of production, I think the analogy holds. In other words, you have less slippage by dealing directly with marketings. So therefore you have a greater success, but it was brought out, I think, the the ingenuity of good business people is that no matter what program is designed there will always be someone that will find a profitable way around the program, and that is just a given. This is not necessarily a condemnation of attempting to try to deal with the government programs. But, no, I think in dairy you have got a much greater chance. Another thing you got in the dairy industry is that it is a domestic industry.

Also, it is a very organized domestic industry with a mechanism to keep track of virtually every pound. There are very few commodities where you can keep track of every pound of the commodity. Again this makes dairy different than a lot of the other commodities.

MR. LAURI: All right, are there any other questions?

If not, thank you Dr. Hamm, we appreciate that.