# Dairy Policy in the U.S.: Towards the Next Farm Bill

Andrew M. Novakovic, Ph.D

*The E.V. Baker Professor of Agricultural Economics*

Cornell University

## Elements of U.S. Dairy Policy

1. Cooperative Marketing
2. Federal Milk Marketing Orders
3. Dairy Price Supports
4. Import Quotas and/or Tariffs
5. Demand Stimulation
6. Production Reduction Incentives
7. Cash Subsidies



## WHY HAVE A DAIRY POLICY?

Marketing programs and regulations generally result from the breakdown of the free market or the inability of the marketing system to achieve desired goals or performance objectives. This breakdown may be real or perceived, but usually involves one or more of the following:

- price and/or income level
- price stability (monthly/seasonal, annual/cyclical)
- income distribution (farm size, region, market)
- industry structure (e.g. farm size)
- cost related externalities ("destructive competition")

Key Concepts:

- Efficiency
- Equity



## MAJOR FEDERAL DAIRY MARKET PROGRAMS

I. Agricultural Cooperatives

Objectives:

improve bargaining power or competitive position of farmers relative to processors

Methods:

legally permit collective action by producers, which otherwise might be treated as collusion or anticompetitive; cooperatives are allowed the implied market power this provides but they may not abuse it.

Law: Capper-Volstead Act of 1922

Current Status: Cooperatives are alive and well -- consolidation but still competitive, very large scale producers are independent minded



## MAJOR FEDERAL DAIRY MARKET PROGRAMS

II. Milk Marketing Orders

Objectives: create market conditions that will encourage:

1. orderly marketing activity; markets that function smoothly, predictably, and at a reasonable cost
2. price stability
3. adequate, and wholesome supplies of fluid milk
4. equitable returns to farmers

Methods:

regulate and supervise the terms of trade between farmers and processors, i.e., set minimum farm level prices and trading rules that determine who qualifies for what price, so as to create market (price) incentives that result in desired market behavior or performance

Law: Agricultural Adjustment Act of 1933, Agricultural Adjustment Act of 1935, Agricultural Marketing Agreement Act of 1937, various modifications introduced by subsequent "farm bills"

Current Status: in some state of flux, no immediate disaster but strong sense that further changes are needed.



## MAJOR FEDERAL DAIRY MARKET PROGRAMS

III. Dairy Price Support Program

Objectives:

- farm price stability
- farm income enhancement
- (market security)

Methods:

purchase storable products (cheese, butter, and skim milk powder) at prices that will yield farm price goal (i.e., the support price)

Law: Agricultural Act of 1949, various changes introduced by subsequent farm bills, effectively neutered since 1989

Current Status: sporadically effective, "tilt" on butter and SMP has been a problem, likely to continue as low level "safety net"

## MAJOR FEDERAL DAIRY MARKET PROGRAMS

IV. Import Quotas and Tariffs

Objectives:

insulate U.S. dairy markets from foreign producers who would like access to supported prices or US market, thereby increasing the cost or decreasing the effectiveness of the DPSP

Methods:

establish limit on amounts (quotas) or taxes on the price of dairy products that can be imported (by country and specific product)

Law:

Quotas - Trade Agreements Extension Act of 1951 and Section 22 of Agricultural Adjustment Act of 1933, terminated by the Uruguay Round General Agreement on Tariffs and Trade

Tariffs: WTO allows for minimum market access and restrictive tariffs on amounts above that level.

Current Issues: US and "world market" prices fitfully moving to convergence, but uncertainty around Doha



## MAJOR FEDERAL DAIRY MARKET PROGRAMS

V. Dairy Promotion and Dairy Export Incentive Programs

Objectives:

Expand demand for dairy products

Stimulate exports and foreign market penetration

Methods:

allow producers and fluid processors to tax themselves to promote dairy products and support demand enhancing product research

Subsidize exports of manufactured products via taxpayer funded price subsidies to exporters

Law: Dairy Production Stabilization Act of 1983 and the Food, Agriculture, Conservation, and Trade Act of 1990, Fluid Milk Promotion Act of 1990

Current Status: some farmers challenging constitutionality of "tax" to fund generic promotion programs. Expected Supreme Court action next year; could go either way. Export subsidies used only half-heartedly by USDA, too little, bad timing



## TEMPORARY DAIRY MARKET PROGRAMS

VI. Production Reduction Incentives

Objectives:

Used twice in 1980s when Price Supports were set too high for too long, to reduce milk production to reduce expenditures under DPSP and thereby avoid (further) price cuts

Methods:

Milk Diversion Program: pay farmers to reduce production while staying in business

Dairy Termination Program: pay farmers to retire themselves, their facilities, and their cows

Lessons and Implications: MDP was expensive and ephemeral. DTP was expensive but more effective (and arguably more humane). MDP will never be adopted again by US, but DTP could be. Producer funded, voluntary initiatives are now available, with "buyout" approach being favored.



## TEMPORARY DAIRY MARKET PROGRAMS

VII. State/Regional Pricing Programs

Objectives:

augment federal pricing programs and target benefits to local farmers

Methods:

Use constitutional device of a Compact to allow states to jointly regulate regional markets by adding premiums to existing FMMO Class I prices (higher price for farm milk used in dairy beverages)

Lessons and Implications: Considerable support by elected state-level officials, even in states with minor dairy sectors. Requirement of federal approval and oversight makes this unlikely as a long term policy (although there is a bill on the table). Popular in states with big beverage milk industry, despised elsewhere.



## TEMPORARY DAIRY MARKET PROGRAMS

VIII. Cash Subsidies / Counter-cyclical Payments (Federal)

Objectives:

augment dairy farmer income, especially for smaller scale farms

Methods:

establish milk price trigger, when benchmark market price falls below trigger, taxpayer funds used to make up difference, up to a maximum production-based amount. E.g. AMTA and MILC

Lessons and Implications: "We prefer fair market prices, but we'll cash the check" Hard to restrict payments based on farm size. Can be VERY expensive. Cost falls on taxpayers rather than consumers. Despite payment limitations, creates incentive to produce (or disincentive to retire) that results in more milk production and even lower market prices.



## Industry Initiatives in Dairy Market Programs

Cooperatives Working Together (CWT)

- Collects money from participating cooperatives and independent producers
- Supports export subsidies and buyouts
- Impact is positive but size is debatable
- Gives producers a sense that they can collectively affect their own destiny without relying on government
- Likely to continue, maybe grow if/as government programs wane.
- Free-rider problem lurks in background

Intervene in Market Exchanges to Bolster Market Price

Marketing Agencies in Common

## Climate for Next Farm Bill

Farm net revenues expected strong for most major crops

Dairy net revenue high in 2004 but prospects poorer in 2005

- Low milk prices as production builds
- Offset from cheaper feed

Implication: grain farmers won't be pushing for change but dairy farmers will (grain usually wins)



## Climate for Next Farm Bill

WTO ruling on Cotton Program provides an impetus to "open up" Farm Bill in 2005

Congress and USDA will likely try to isolate any changes



## Climate for Next Farm Bill

IT'S THE BUDGET

US economy is growing, but jobs and household income still sluggish; prospects for new revenue weak

Republicans push for tax reductions

War on Terror, esp. Iraq, will continue to consume huge $ amounts, with no end in sight

Implication: no new money for agriculture, hard-pressed to hold on to what we have



## No Obvious Choices

Price Supports can be fairly cost effective in terms of taxpayer $, but creates problems with trade.

Cash subsidies make the price problem worse and cost a lot of tax $ we don't have.

Federal Orders don't really enhance prices enough to matter.



## Where do we go?

Organized farmers

- Maintain/protect existing programs
- Enhance voluntary programs

Disenfranchised farmers will create political agony but no solutions; continued regional bickering

Processors generally favor deregulation, unless it makes them worse off. Not politically potent

Consumers are disorganized and unmotivated

Taxpayers are motivated, fairly potent, but not focused on specific programs



## What will happen?

Near term change for dairy unlikely

Doha has potential to define the choices against which US dairy participants will react.

- Protectionist sentiment roughly balances the global optimists

Economic Growth could make huge difference on legislative options.

## Cornell Program on Dairy Markets and Policy

For more information:
http://www.cpdmp.cornell.edu


Andrew M. Novakovic, Ph.D.
Program Director, amn3@cornell.edu
Mark W. Stephenson, Ph.D.
Senior Extension Associate, mws5@cornell.edu
Charles F. Nicholson, Ph.D.
Senior Research Associate, cfn1@cornell.edu
Angela M. Gloy, Ph.D.
Research Associate, amg69@cornell.edu