

Z
TA265.6
B183 de
15:1



Texas Agricultural Extension Service
The Texas A&M University System

Balanced Dairying ECONOMICS

Government Publications
Texas State Documents

JUN 20 1995 *pe*

Vol. 15, No. 1

Robert B. Schwart, Jr.

Robert B. Schwart, Jr.
Extension Economist-Dairy Marketing
Department of Agricultural Economics
College Station, TX 77843-2124
(409) 845-5284

Depository
Dallas Public Library

May 22, 1995

Potential 1995 Dairy Policy Options

by Robert B. Schwart, Jr. and Joe Outlaw

During the coming months, debate in the agricultural committees in both houses of Congress will focus on farm program legislation. The mood in the new Congress is for less government spending and agriculture is no exception. Dairy producers could see a complete change in their program. What finally becomes law is purely a guess at this time. However, producers are asking what we expect might happen, so the options that have been discussed so far will be presented.

Support Program Changes

There is a very good change that the price support program will be changed or eliminated in the 1995 farm bill. Most dairy producers want the Gramm-Rudmann assessment removed yet many of these same producers want to keep the support program. The reality of the situation is that if the assessment is removed, the support program will likely be abolished. Among the support program proposals are cuts in the level of support prices, elimination of purchases of some commodities (butter and non fat dry milk) but maintaining the purchases of other commodities, or eliminating the purchase program all together. One such proposal calls for the elimination of the price support, but the federal government would be mandated to purchase food for aid.

One support program proposal calls for the continuation of the purchase program. However, the support would be lowered to \$9.10 in 1996 and then cut each year until it reaches \$8.10 per hundredweight by the year 2000. For the past five years, support price levels have been so low that the Federal government has purchased significantly less product in conjunction with the operation of the price support program than during some periods in the past. The Minnesota-Wisconsin (MW) price has averaged more than above support. During much of this period, milk prices have fluctuated and have fallen close to support, but have never stayed down long enough to trigger much in the way of sales to the CCC by processors. Consequently, Congress may conclude that the industry does not need a support price as high as the current level or that a purchase program is even needed. Variations of the support program include keeping the support for cheese at \$10.10 but removing the support for butter and non fat dry milk powder.

While it is not a price support proposal, a recourse loan for non fat dry milk is being discussed. The program would be used by processors to finance and manage inventories. Recourse loans must be repaid with interest by a specified date which would somewhat deter their use by the industry.

Export Program

The potential does exist, given the economics of milk production, for milk supplies to exceed domestic needs. Proposed export programs include maximizing the use of the Dairy Export Incentive Program (DEIP) and a proposal to use an export board and market development program to move products into the world market. Because there is interest in exporting, Congress may draft legislation allowing an export option that is legal under the GATT agreement. GATT legality requires there be no price support involved with an exported product or limits on export subsidies will apply. If funding is required to operate such a program, Congress may devise legislation that requires milk producers themselves to fund such export programs.

Federal Marketing Order Changes

Steve Gunderson, Representative from Wisconsin and chairman of the House Livestock, Dairy, and Poultry Subcommittee has indicated that he wants federal orders changed. Upper Midwest sentiment is that the South is unfairly compensated for its milk and that the Upper Midwest is inadequately paid for its milk. The order issue is very complex and it is this complexity that is a significant part of the problem. Federal order options that may be discussed in committee are: eliminating the orders; lowering Class I differentials; raising Class I differentials; merging orders; making one national pool for Class I milk; making one national differential for Class I milk; or any combination of proposals.

Change Federal Marketing Order Price Structure

There is growing concern that the current formula for determining Class prices is not performing. The current Class I and Class II prices are tied to the Minnesota-Wisconsin (MW) price for manufacturing grade (Grade B) milk. The Class I differential is added to the MW price two months preceding to establish the current month Class I price. The Class II price is tied through another formula. The current month Class III price is the current month MW. Since there is growing concern that the MW does not reflect market conditions in the manufacturing market, so it will not reflect the fluid milk market and Class II product market conditions. Proponents want to replace the MW as the Class III price and to decouple the Class I and Class II prices from the new Class III price. Class I and Class II prices could then be changed quarterly based on market conditions for dairy products.

Eliminating Orders

Federal milk marketing orders were initiated to assure that all milk sheds had an adequate supply of fresh fluid milk for beverage use. Since enabling legislation was passed by Congress in 1937, the structure of the industry has changed. Some order opponents argue that marketing orders restrict interstate commerce and are blamed for encouraging production among inefficient producers. Milk produced virtually anywhere in the United States can be used to meet the market needs in any other area with no loss in quality. The Grade A standards for production are virtually identical among all the states. The technologies for storing and transporting raw fluid milk allow milk produced in New Mexico to be in a Chicago supermarket case within 36 hours after that milk leaves the cow. Most of this milk is marketed through cooperatives, and some feel cooperatives can handle almost all of the functions of an order. Competition among cooperatives, large independent dairy producers and among processors, it is argued, would determine fair prices. Market driven product demand and supply could determine the prices paid producers. For many proponents of eliminating orders the issue is as simple as eliminating a layer of government regulation. Eliminating federal orders likely will result in producer prices below current levels in the South and Southwest.

Merging Orders

Merging orders maintain market regulation but recognize existing marketing patterns. Nearly all product identity and processing sanitary standards for beverage milk among all the states are identical. Coupling identical standards with current transportation technologies allows milk processed in a bottling plant in Portales to be in a supermarket in Atlanta. Milk processed in a Missouri plant may be sold in a Shreveport convenience store. In many regions of the country, smaller fluid processing plants have ceased operation, and the distribution areas formerly serviced by those plants have been absorbed by larger plants. Much of the milk marketed in this country moves through large supermarket chains that process the milk and distribute it through a central distribution system. This milk may be marketed across several marketing orders. Consequently, since both finished products and raw milk can and do move with relative ease throughout the country, orders could be combined in such a way to match current milk marketing patterns.

One National Order

Proponents of one national order argue that it makes little sense to have more than one federal order since milk can move so easily from one area to another. Those supporting one order contend, regardless of origin or destination, all Grade A milk is the same. Nearly all the milk marketed in the United States is Grade A and both fluid processors and processors manufacturing products essentially compete on a national market for milk needs. Products manufactured from this milk do compete nationally. Further, since milk for beverage (Class I or fluid) use does command a higher price it makes sense to proponents of one order to share in the proceeds from milk sold for fluid use. If one order is introduced, it is unclear how prices in the southwest would be impacted.

One National Pool for Milk

The milk pool is the total dollar receipts from the sale of milk. This pool is divided among the producers whose milk was used to create the pool.

One way a national pool could be created is to have all milk sales receipts across all orders added together and then divide the total among all producers contributing milk to create the pool. Under this arrangement, the Class I milk sold in each marketing order would be valued at the Class I price in that order. The Class II milk would be valued the same across all orders at the Class II price. Class III milk would be valued across all orders at the same Class III price. Class IIIA milk would be valued at the same Class IIIA price across the markets having Class IIIA milk. The resulting price is a national uniform or blend price. Class I differentials may not be changed if this procedure is adopted. The national uniform price would pull prices up for producers in federal orders with low fluid utilization and high manufacturing utilization while reducing blend prices in high Class I use markets.

Another proposal for a national pool relates to the removal of butter and non fat dry milk from the support program. This proposal is being introduced in an effort to expand butter and non fat dry milk exports beyond GATT limitations and to eliminate the budget assessment. Proponents argue that removing these products from the support program will reduce the total value of milk in the market system. However by exporting them, it may help to maintain producer prices. Since all producers would benefit, a national pool would be used to distribute the difference in the value of the

product at support levels and the market value.

A third proposal is to create a national pool to compensate for losses attributed to a change in the MW price. The pool distribution would be in proportion to the market milk used in Class III products. Losses in value due to MW changes would be made up by increases in the Class I and Class II prices.

Leveling the Class I Differential

One proposal that is gaining momentum among some dairy producers is a single Class I differential for all beverage milk marketed in the United States, or at least for all federal milk orders. One version of this proposal is to level the differences between orders by raising the minimum differential to a higher level. There would also be differentials for distance within markets. It is likely that over order premiums would have to be used to move milk across orders. The net affect, in general, would be to raise uniform prices in northern states.

Changes in Existing Differentials

In 1985, Congress legislatively changed the Class I differentials in all orders. The result was a generally higher average differential across all orders. Differentials were raised in both the north and the south but some felt that southern order differentials were raised too much. Differentials were also adjusted somewhat east and west to accommodate alignment between adjacent orders and to account for pockets of surplus milk. Milk production was expanding in the southwest prior to the differential increases but to detractors this production increased at an increasing rate after the differentials were changed. At the time the south was expanding, many northern producers were exiting the industry. The blame for southern production growth was placed on southern differentials. Consequently, there is political pressure to lower southern differentials and/or raise Northern differentials.

Eliminating Differentials

There is a remote possibility that federal orders would be kept but that fluid milk differentials would be eliminated. Milk could be priced at one minimum price for all uses. Essentially, there would not be any Class price. Processors of milk for all uses would compete with each other for supplies. Milk prices between marketing regions would differ by the cost of moving milk or dairy products from the market region

with a surplus to the market region with excess demand.

Changing Basepoints

Currently, Eau Claire, Wisconsin is the basing point for pricing fluid milk. Current Class I differentials are composed of two parts, a Grade A differential and a distance differential. The distance differential reflects the distance to the market from Eau Claire. With the growth of production in the west and southwest, localized pockets of "surplus" milk have developed because there are not enough processing plants to manage all the milk available on the market during certain times of the year. One approach proposed to aid in moving supplies from these pockets of excess supply to areas needing fluid milk, is to designate several of these "surplus" markets as base points. If multiple base points are introduced, the Class I differentials at each base point would consist of a Grade A portion plus a portion for local transportation within a market. There is disagreement whether multiple base points will eliminate perceived pricing inequities among markets.

Component Pricing

If component pricing is introduced into the market, producers would be paid according to the amount of protein or solids, not fat, and the amount of milkfat sold. If component pricing is introduced for all Classes of milk within an order, then minimum solids standards for fluid milk products would have to be increased as the cost of higher solids in a fluid product could not be recovered in the market. Fluid milk processors selling lower solids milk would have a cost advantage over fluid processors selling higher solids milk if solids in fluid milk were not standardized at a level above the current 8.25 percent minimum.

Summing Up

The key to legislation is to be market oriented, save the federal government money, stay GATT legal, sell internationally, and recognize that the industry is changing. Regardless of the changes, Texas and Southwest milk producers likely will see price levels fall somewhat under the new farm bill.