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REFLECTIONS ON CRITERIA AND STRATEGIES
FOR CHOOSING AMONG
DAIRY PRICE SUPPORT PROPOSALS

by

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Preface

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One year ago this month a special meeting of dairy industry leaders was held in Kansas City. The National Dairy Symposium was organized by the Secretary of Agriculture to give interested parties an opportunity to express their views on price support policy. I think many of us expected, or at least hoped, that this conference would result in a popular, coherent solution to dairy policy related problems. In the past 12 months we have heard many speeches and read many articles and papers on price support policy, but I think we would all agree that we have not yet found a solution to the problems that have hounded the dairy industry for the last three years. Moreover, USDA dairy market estimates for 1983 indicate that the most conspicuous problems of excess milk production and large government purchases are in fact worsening, and many analysts are now projecting that this pattern will continue through the end of 1983.

Those who work to shape or make dairy policy have found it difficult to reach agreement on the steps for solving these problems. It is becoming increasingly difficult to generate fresh ideas to restore the deadlocks that exist between and among the various groups representing the dairy industry and government. My goal today is to try to identify some factors that I think are impeding the policymaking process and to approach dairy policy options from, perhaps, a slightly different angle. I hope that this will help to stimulate additional thinking about how to evaluate and choose among the many proposals that have been made.

A Problem Does Exist

So much has been said on the problems associated with price support policy that many people have been numbed by the litany of events and statistics that describe the dairy situation. Some have even questioned whether or not a problem actually exists. I, and I am sure many of you, have even been asked whether or not the "so-called problem" was somehow contrived by "Washington" for some unknown, mischievous purpose. Such thinking is fanciful indeed. The fact that a problem exists is beyond question. Moreover, I think you as leaders in the dairy industry play a very important role in disseminating accurate information and in helping members of the industry gain and keep a realistic perspective.

What Is The Problem?

Recognizing that a problem exists only gets us over the first hurdle. The next and very important steps are to identify what the problem is and, if the problems are multiple, to rank the importance of each component. This seemingly simple step has been, in my opinion, one of two major obstacles to achieving a solution to our problems. I will discuss the second in a little while.

Although we can agree on the data that describe the problem, we do not seem to agree on what the problem is. It is clear that commercial use of dairy products is less than total marketings of milk. Some see this as a problem of low sales that should be expanded by domestic promotion or international sales. Others see this as a problem of excess production. Still others describe the problem as high USDA purchases of manufactured dairy products and the cost of these purchases. As in the story of the blind men and the elephant, we are all seeing the same beast but describing it in a different way.

Perhaps these are honest differences of opinion with no totally right or wrong positions, but the point is that we should recognize that remedies for one problem may do nothing to help another problem and may even make that other problem worse. Until we can reach some kind of consensus on what the specific problems are and their priority, it will be extremely difficult to agree on a solution.

I would like to briefly share with you some of my thoughts on what our problems are. In my view the principal and overriding problem, or at least the most serious economic problem, is excess production. Perhaps we should say that this is a symptom of a more fundamental problem, i.e., price supports were set at levels well above those that could be justified by market conditions and this problem was made worse by a weakening economy and declining or stable feed prices. While I think this problem is paramount, there are other important problems that deserve attention.

The dairy industry or at least some parts of it seem to have lost sight of the fundamental need to market its product. Product promotion and development will not close the gap between supply and demand, but it can only help and should be part of a long-run strategy. Moreover, it is going to be hard enough to develop domestic markets. Unless there are major changes in world trade prices, expanding export markets do not seem to offer much hope as a viable, long-run strategy.

One problem that I think is very important but that I have heard little about is the extreme distortions that have been introduced to wholesale markets for cheese, butter and nonfat dry milk in order to achieve the farm price support goal. If milk equivalent net removals look large when compared to total milk marketings, they look enormous on a product basis. When cheese, butter, and nonfat dry milk were basically residual products used to balance seasonal supply and demand, this type of situation might not seem terribly alarming. Cheese markets serve much more than a balancing function today. I think we should question whether it is a good idea to stifle sales and encourage the use of substitutes by artificially holding cheese prices above normal market levels. Butter and nonfat dry milk remain the residual uses of milk and as such are appropriate vehicles for the price support program; however, even in these markets I think we must question whether we have set purchase price levels so high that we have created more problems than we have solved. Many butter/powder plants that once operated primarily during the Spring flush are now open all year-round and actively compete with fluid milk plants and other plants producing products for commercial markets.

Many people have been suggesting that federal order transportation differentials are too low to encourage milk to move from manufacturing areas to fluid plants, some are even advocating that manufacturing plants be paid a bonus to cover their "give up" cost when they ship milk. It has always been cost effective for manufacturing plants to run at full capacity all year-round, yet year-round manufacturing was atypical of the traditional balancing plant until recently. Perhaps high purchase prices and an unlimited government market has contributed to the problem fluid handlers have had in competing with manufacturing plants for milk.

Another important problem in my view deals with what we have led farmers to expect from the price support program. Beginning a few years ago, high support prices, the promise of 80% parity, and semiannual adjustments led dairy farmers to expect regular and substantial increases in prices. They responded by increasing production. Now it appears that many farmers expect that policymakers are obligated to make the needed adjustment process painless. The attitude seems to be "you got us into this mess now you get us out."

The latter is perhaps as much a political problem as it is an economic problem. Probably the biggest political problem is the cost of the price support program. While I, as an economist, see an imbalance between supply and demand, most politicians are seeing dollar signs. Whether or not $2 billion is "big" or "too high" varies with the eye of the beholder, but when the political powers agree that the cost of dairy programs are much too high, whether it's at $2 billion or $200 million, the dairy industry has a political problem. In arriving at solutions to the economic problems we probably cannot afford to ignore this political problem.

The final problem on my list also has economic and political dimensions. This is the problem of what to do with our massive stocks of cheese, butter, and nonfat dry milk. I think we must avoid, at almost all costs, letting this problem go to the point that we have no choice but to destroy spoiled dairy products. That would be much harder publicity to survive than the cost of the program. If we eventually use export markets to rid ourselves of this surplus, this will be the reason why.

To summarize, I think there are several important problems, but the chief economic problem is excess production caused by higher than necessary prices and the principal political problem is the cost of the price support program, with the time-bomb of massive stocks a close second.

The Nature of the Problem

Earlier I mentioned that I thought there were two major stumbling blocks to the resolution of the dairy policy debate. The first occurs in identifying and ranking problems. The second is in identifying the nature of the problems. The question I have in mind specifically is "Is this a long-run problem or is it likely to correct itself with relative ease in the short run?" I think this is a particularly important question to ask when we survey the prospects for bringing supply and demand back into balance.

Periods of overproduction are common in agriculture. Exceptional weather or unpredictable drops in world demand have frequently been responsible for excess supplies of food and feed grains. Such causes of overproduction are by definition abnormal. They are short run and tend to even themselves out over time. Nonetheless, it can be helpful to have temporary policies and programs to deal with the short-run disruptions that occur, to have a policy that is designed to be effective for a short period but for long enough to deal effectively with the problem.

Many people have been approaching the dairy problem and remedies for it as if it were similar to the cyclical overproduction problems common to grains and other crops. After all, it can be argued that low feed prices and a weak economy have been important problem-causing factors for dairy markets and they will improve eventually. But I think those who propose temporary programs that give individual farmers incentives to adjust their production are not being realistic. Paying farmers to not use all of their production capacity does not make that capacity go away. Unless there are fundamental changes in dairy markets, unless we reach a point where our current capacity to produce matches our desire to consume, a program built around marketing quotas does not solve the problem it only treats the symptom. Given the prospects for even more dramatic growth in production per cow and continued flat-to-modest growth in total consumption, the inherent overcapacity problem can only get worse. Once we enter a program to set aside capacity without eliminating it, I think we must admit to ourselves that we are only treating the short-run component of our problem and that we have yet to deal with the long-run problem.

Choosing a Strategy to Match the Problem

How, then, do we deal with these complex problems? After we have thoroughly identified, ranked, and defined our problems, I think we should consider our strategy for solving it. We can use one of four strategies.

First, we could create a remedy for the short-run problem and worry about the long-run problems later. In this category I would put proposals that promise to give producers temporary incentives to hold back their production until the program expires in a couple of years.

Second, we could create a solution to the long-run problem, wait for it to work, and ignore the short-run problem. In this category I would put proposals that say let's simply freeze the support price and wait for the problem to go away. That solution will work eventually, and it may work faster than many have predicted, but it does nothing in the short run. Our political problems are probably so severe that we can't afford to wait. This strategy may not be politically viable.

Third, we could adopt a long-run approach and try to make it solve the short-run problem as well by making the approach harsh or tightly disciplined enough to work in the short run. In this category I put proposals that call for large, fast drops in the support price. If holding supports constant will eventually work, then decreasing the support price should work faster, but trying to make this approach work very quickly by dropping the support price by a large sum may create more problems than it solves.

Finally, we could combine short-run and long-run solutions to address both aspects of the problem. This approach may be the most reasonable to take, but it is the most difficult to design. Many people who have proposed short-run solutions have argued that this is their ultimate strategy, but I think for this strategy to work well one needs to think through the long-run strategy before implementing the short-run solution. If we do not, we run the risk of creating a short-run solution that only makes the long-run problem harder to solve. This approach requires a well thought out plan for blending the short-run solution into a longer-run program.

Strategic Philosophies

In addition to matching long- and short-run problems with appropriate solutions, we must think about the kind of a solution we want. Almost every price support proposal that has been made in the last several years would work to one extent or another, but some would work in very different ways from another.

I think another large obstacle to resolving the policy debate has been differences in philosophical approach, in how to solve the problem. I think the proposals we have heard can be more or less categorized as one of two types. I call them the:

1) Let-the-chips-fall-where-they-may approach or philosophy, and
2) Share-the-burden-of-adjustment approach or philosophy.

For example, an across-the-board price approach exemplifies a let-the-chips-fall-where-they-may philosophy. It lets the market decide how production will be cut and it means that some farmers will go out of business. An approach based on marketing quotas and/or "voluntary incentives" reflects a share-the-burden-of-adjustment approach. Advocates of this approach feel that the let-the-chips-fall-where-they-may approach is too harsh and unfair. They prefer to have everyone cut back a little bit rather than put people out of business.

Neither approach is right or wrong, they are simply different. Each of us must decide which approach is right for us, given our values and beliefs.

Towards a Solution

It is your responsibility as leaders in the dairy industry to arrive at a solution; I hope my remarks have helped you rethink how to accomplish that. A solution of some type is inevitable, the question is do you want it now or later and do you want to have any influence on what the solution is. If the various parties in industry and government wish to reach a solution at the bargaining table, so to speak, then I think all must step back a few paces and think about why they have differences in policy approaches and whether the approach each has taken really does what he or she wanted it to do.

If we don't know what the problem is, how can we design a sensible program. If we can't agree on the problem, we can't agree on the solution. And, if we can't agree on the solution, someone else will make the decision without us. The way things look now I think someone may well be making a speech similar to this one at the 1984 Northeastern Dairy Conference. If we are to avoid that we must all unlock our horns, step back from the heat of the battle and reassess what we need to do and how we can best do it.