Implications of the Omnibus Budget Reconciliation Act of 1982 for the Dairy Industry with Special Reference to the Cheese Subsector

by

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Preface

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The purpose of this paper is to discuss the recent changes in price support policy and their implications for cheese manufacturers and the dairy industry in general. Basically, the new price support legislation calls for freezing the support price at its current level for the next two years. In addition, it provides for deductions of up to $1 per cwt. from the price paid to dairy farmers for milk, if government purchases exceed certain levels.

Let's review just briefly how this particular plan evolved. Although the current problem of overproduction and high government expenditures under the price support program has much earlier roots,[1] let's begin in March of this year.

In response to a burgeoning oversupply of milk and milk products and unprecedented price support expenditures, the Secretary of Agriculture called for a meeting of dairy industry representatives and interested parties to discuss policy options for correcting the problem. The Kansas City meeting resulted in dozens of speakers and proposals. Some of these proposals called for entirely new and different programs; others suggested modifications to the existing price support program. Options were offered that would replace the current program; others ran parallel to or in conjunction with the price support program.

Out of this cacophony of advice, the administration developed a package of corrective measures with the key proposal being the authority to reduce the support price. In the meantime, Congress worked on its own proposals. In the end, the House passed legislation virtually identical to the National Milk Producers Federation's proposals. The key feature of this plan was a pricing system that held base prices for milk at current levels or higher but provided for farmers sharing in the cost of the price support program through direct assessments. The level of an individual farmer's assessment depended on the relative amount of surplus milk nationally and relative changes in the amount of milk the farmer sold. The Senate, on the other hand, eventually passed legislation that would simply have frozen the support price at its current level.

How these three disparate plans would be reconciled did not seem obvious, but a compromise was reached that is now law. This price support plan will keep support prices constant, which the Senate wanted; it will reduce the price received by farmers and presumably discourage milk production, which the administration advocated; and it will permit direct sharing of government costs with dairy farmers while differentiating between farmers who expand or contrast their milk production at different rates, which the House wanted.

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[1] For an explanation, see The Dairy Industry and Dairy Policy in 1982, Andrew Novakovic, A.E. Ext. 82-4, Department of Agricultural Economics, Cornell University, February 1982.

The Plan and Its Implementation

As is often the case with complicated plans, there has been some confusion about what the plan is and how it will work. Let me discuss the plan itself for awhile. Some of the specifics are known, in some cases I am speculating.

From now until September 31, 1984, the support price will be $13.10. For the year beginning October 1, 1984, the support price will be adjusted to equal the level of parity that $13.10 represented on October 1, 1983.

Beginning this October, the Secretary can deduct 50¢/cwt. from the price farmers receive. He is authorized to do so until such time as projections for price support purchases for the fiscal year go below 5 billion pounds M.E. The Secretary is further authorized to collect an additional 50¢/cwt. from dairy farmers beginning next April if projections for fiscal year purchases equal or exceed 7.5 billion pounds M.E. However, the Secretary must also provide for refunding all or part of the second 50¢ assessment to farmers who reduce the amount of milk they sell compared to their marketings in a previous recent period.

The deduction would be made on <u>all</u> the <u>milk</u> sold by <u>all farmers</u>; however, the assessments are <u>not</u> mandatory. The Secretary is simply authorized to make them if the appropriate purchase levels are triggered. Given that CCC purchases are currently running at about 13 billion pounds, it seems highly likely that the Secretary will be able to make both assessments.

The specific procedures for collecting these assessments have not been announced, but the processors who first purchase a farmer's milk will be responsible for making the assessment and remitting it to the appropriate agency. In other words, dairy plants will pay a lower price to their farmers but will be required to send in 50¢/cwt. (or $1) on all the milk they buy from farmers.

Handlers who are regulated under federal orders will likely be audited for their compliance with these provisions as part of the regular marketing order function. It is much less clear how other handlers will be monitored. Although the law provides for penalties to handlers who fail to comply, a monitoring and enforcement procedure for handlers not regulated by federal orders would have to be developed from scratch. Although a few states have marketing order type regulations comparable to federal orders, approximately one-fourth of the milk marketed is not regulated in this fashion.

It may be possible to extend the responsibilities of Market Administrator's to unregulated plants; however, this would require a considerable expansion in the auditing staffs of most Administrators. There are some indications that USDA will rely on voluntary compliance by unregulated plants instead. If so, it seems safe to say that compliance with the law will be uneven and difficult to ascertain. If manufacturers find that they can easily evade the assessment, this could result in many regulated manufacturing plants voluntarily failing to meet the requirements that qualify them as pool plants. Such maneuvers would be understandable but would, on the whole, create unnecessary disruptions in the marketplace. Moreover, if taken to the extreme, this would imply that virtually all fluid milk processors would pay the assessment but dairy product manufacturers may or may not. If the program were to discriminate between types of processors, it would be more logical to do just the opposite.

All of this is very speculative. It is very difficult to predict how successful the USDA will be in accurately collecting the assessments that are due, especially since specific plans have not yet been announced. I have no doubt that USDA will make every effort to come up with a plan, but probably we will not be able to judge the effectiveness of the plan until after it goes into effect.

As problematic as the assessments are, it is even less clear how the refunds will be made to farmers who reduce their marketings. An accurate and equitable refund procedure will require an enormous amount of documentation and lengthy reviews. It is not an impossible undertaking, but it seems to me that it is a very costly one. The prospect of this alone should compel us to seek alternative solutions.

USDA has yet to announce what it will do to purchase prices for dairy products. Given their policy of the last two years and the current climate, it seems unlikely that the make-allowances will be adjusted to reflect increases in processing costs. Purchase prices will probably stay at current levels, i.e.,

$1.52 per lb. for NY butter
approximately $ .95 per lb. for nonfat dry milk
$1.395 per lb. for blocks of cheese, and
$1.365 per lb. for barrels of cheese.

One of the few benefits of the new program to cheesemakers is that purchase prices will not decrease. This helps to protect the value of your inventories, but it is probably not safe to think that the problem is averted. You have bought some time, but in the meantime I think it would be wise to hold no more stocks than are needed based on your expected sales, and I would be conservative when estimating sales.

Consequences of the Program

What is the economic outlook for the dairy industry under this program? The impact on prices is fairly easy to project. Market prices at the farm will continue to slip below the price support goal. Taking into account the assessments, the price received by farmers in 1983 for Grade B milk could be well over $1 less than the support price. This implies net prices for dairy farmers in New York falling close to $12 per cwt. and possibly below that in some months.

Under the new program, the reduction in prices received by farmers (i.e., the assessment) will not be reflected in prices at the wholesale and retail levels. The total cost of milk to handlers will not decrease; therefore, there will be no savings to pass along to consumers. Wholesale prices of supported dairy products will continue to rest on the purchase prices set by USDA.

Under these circumstances, it is clear that there will be less increase in sales of dairy products than would otherwise be the case. Retail dairy product prices will increase slightly with processing and marketing costs, but these increases will be less than the increase in prices for food in general or other competing products. Hence, dairy products should become increasingly attractive to the price conscious consumer. Nevertheless, we should not expect much more than the recent modest gains in overall dairy sales of about 1%.

The big question continues to be what will happen to milk production. Many are predicting that production will increase as farmers attempt to maintain gross income levels. For some farmers, this will surely be the case, but I am equally sure that there are some farmers who simply will not survive the assessments. What will the net effect be? Given the prospect for low feed prices, lower interest rates, and an economy that is slow to provide attractive alternatives to dairy farmers, we may be lucky if production holds constant next year. Despite the rather hefty drop in net farm prices, the stage does not yet seem to be set for major reductions in milk production.

If this is correct, we can expect continued overproduction and large CCC purchases. Although CCC expenditures will show a decrease due to some $650 million to $1 billion collected through assessments, this will be of only small benefit to taxpayers and hardly seems like a worthy long-run plan when considering all the other problems it entails.

Conclusions

It might be appropriate at this point to ponder what can or should be done in response to these policy changes. The best we can do may be to just sit back, watch and wait. The administration has made it clear that it is not satisfied with this new policy. However, it has also made it clear that it will be happy to collect assessments until it can convince Congress to change the program. There is already evidence of a considerable and growing dissatisfaction with this plan by all segments of the dairy industry. This should put significant pressure on Congress to change the policy again, even more so if the implementation of the plan proves to be highly uneven and unworkable.

In this environment it is not at all clear that the second assessment will ever be made. Dairy policy could very well be changed again by April 1. In fact, I am not convinced that the first assessment will be made. It seems quite possible that the Secretary will delay implementing the assessment until after the election. By that time enough other things could change or take place that would persuade the Secretary to abandon the idea altogether. Unfortunately, it is hard to be optimistic about the prospects for a new plan. It is a bit difficult to imagine that the new Congress will be much different than the Congress which enacted the policy we now have. The post-election debate could simply be a rehashing of all the proposals and arguments that have been voiced for the last six months. Despite popular sentiment, Congress may not change its plan unless it proves to be a major failure, which is a distinct possibility.

In my judgment, we have yet to come up with a sound, workable long-run dairy policy, and I am doubtful that the new program is even a good short-run solution. Congress and the USDA have backed into a corner. I doubt there are any pleasant solutions available. Although I am sympathetic to their dilemma, the recent see-saw battle over dairy policy must stop. Politicians will have to forego the games of politics and behave as serious legislators if we are to return to a stable dairy sector that provides fair returns to producers at a reasonable price to consumers.