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SOME ISSUES CONCERNING DAIRY POLICY IN 1985

by

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Gentlemen of the House Subcommittee on Livestock, Dairy and Poultry, I am pleased to have the opportunity to visit with you today about the dairy industry and dairy policy. For your information, I am Andrew Novakovic, a resident of Ithaca, New York and an assistant professor in the Department of Agricultural Economics at Cornell University. Since I came to Ithaca in 1979, my responsibilities at Cornell have focused on research, extension and teaching related to dairy marketing and policy.

I shall keep my formal remarks brief but I would be very pleased to respond to any questions you might have following my presentation and those of my colleagues. My formal remarks are limited to three general topics. The first topic concerns the dairy industry in the Northeast.

The Northeast Situation

Although I am from the Northeast, I do not presume to speak for the Northeast dairy industry on matters of policy. However I would like to offer my opinions on conditions facing the northeastern dairy industry. To that end I would also share with you an excerpt of a paper I and two of my colleagues at Cornell prepared for Governor Cuomo's Agriculture 2000 Conference. The Agriculture 2000 paper describes the scale and scope of New York's dairy industry, characterizes the balance between milk produced, processed, and consumed in the state, and discusses some of the major forces that will impact the dairy sector over the next five to fifteen years. While I would refer you to this paper for details, I would also offer some general observations.

The dairy industry in the Northeast has two important things going for it. First, the Northeast is agronomically very well suited to an agriculture based on ruminant animals. This suggests to me that this area of the country, and others like it, will continue to be a sensible place to milk cows. Second, although population in the Northeast may decline for a few more years, this area is still home for a large share of our country's people. Because of this and despite the fact that it is the second largest milk producing area of the country, the Northeast is a net importer of dairy products.

Milk producers in the Northeast are close to large markets and have favorable natural conditions that result in a comparative advantage so I am optimistic that farmers in this part of the country can maintain their share of national markets and perhaps even gain a greater share. This is not to say that adjustments are not necessary or that they will not be painful for some. Returns to dairy farmers in the Northeast have suffered in recent years and likely will deteriorate further before they improve. The opportunity to recover and prosper exists, but it is by no means guaranteed.

In the Northeast and nationally, steady increases in farm productivity and labor efficiency have resulted in declining farm numbers over the last 100 years, and this trend will likely continue. As farmers become fewer in number they will also become larger in size. This, however, does not imply the demise of the family farm, unless one has a very narrow definition of that structure. Farm families are likely to continue to provide most of the management and capital to the farm enterprise, but they will continue to move in the direction of providing less of the labor. In fact, making this transition is necessary if the Northeast and other traditional milk producing areas are to remain competitive with other areas that are already reaping the benefits from the specialization of labor and management.

Policy Objectives and Options

The second leaflet in the series on Dairy Policy Options for 1985, which was passed out earlier, was written by me and relates to this section. The main point I wish to emphasize here is that the debate over dairy policy options would be greatly improved if all participants would first come to grips with the problem of identifying policy objectives. While we might not all agree on what the objectives of dairy policy should be or on how to rank the importance of each objective, at a minimum we should be able to clearly prioritize our own objectives and relate them to the options we propose.

If our objectives are well defined, our policy choices are more easily identified. Consider the following examples. If we wish to reduce government cost, the most effective way is to eliminate all programs; the next best way is to reduce program benefits (e.g., prices or payments); the third best way is to transfer the cost to another party (e.g. assessments on farmers). If we want to lower consumer prices, the most effective way is through a target price-deficiency payments scheme. If our goal is to preserve the current structure of dairy farming, at least in the short run, the most effective way is through supply control programs. If we wish to set farm prices at some desired level, based on farm costs or other criteria, the most effective way short of a minimum price law, is the traditional support price program; the next best way is through a target price program with no payment limitation.

More specific procedures can be used to achieve more specific objectives, such as targeting benefits to producers of different sizes or income levels or to those located in different regions. Once again, the point is that good programs are much easier to develop if we first grapple with and identify some fairly specific policy objectives. Whatever any of us may think of the President's proposed legislation, it at least lays out its objectives plainly. I would encourage all other parties to make sure they have done the same before they become embroiled in further debate over specific program changes. Those who disagree with the President's proposal, or any other, most likely disagree with its objectives.

Flexibility and Security

Many objectives and effects can be ascribed to past Federal dairy policy. I am inclined to think that the most important effect of the dairy price support program has been enhanced market security. By security I do not mean guaranteed prices at a level that ensures that all farmers will make profits, in fact the latter is essentially impossible. Rather I mean that federal policies have created a market environment wherein buyers of milk are able to offer almost all farmers an outlet for their milk at a predictable and stable price.

Security and stability, depending on the degree to which they are pursued, may come at the expense of flexibility. Much has been said in recent years about both flexibility and stability. Any program can be made to be as flexible or result in as much stability as may be desired. Whatever level of flexibility or stability is desired, I would suggest that two important considerations will or should prevail. The first of these considerations is predictability. It is probably true for all economic policies that the affected parties want at a minimum a program that is predictable. If change can be anticipated smooth and orderly adjustments can be made. Obviously predictability alone does not make good policy, but good policy surely must have predictable consequences.

The second major consideration has to do with the economic factors and forces that surround the dairy industry. Dairy price support policy, while important at the margin, cannot override basic underlying economic forces, at least not in the long run. Consider for example the milk diversion program. The program led to reduced marketing of milk by providing temporary incentives to farmers; however, it did not change the underlying incentive to produce more milk than can be used commercially that exists at the current support price. Federal programs can be used to buffer economic forces of change, but in the long run basic forces of supply and demand cannot be ignored.

This returns us to the concept of flexibility. Attempts to use price supports to override the economics of supply and demand will ultimately fail. The support program must be able to flex with the economic winds. Perhaps federal policy is best used as a buffer against large, short term changes in economic factors that could needlessly disrupt markets -- such as a large change in feed prices due to severe weather -- or to smooth the adjustments required by more permanent force of change -- such as improvements in farm efficiency due to technological change. The latter may be particularly important in the next five to ten years given the rapid and possibly dramatic increases in farm productivity that could result from advances in biological and electronic technology.

The brief presentation that I and my colleagues have or will make undoubtedly leave many questions unanswered. I will happily respond as best I can to any questions you might have.

ANDREW NOVAKOVIC

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