Bulletin 743
Agdex 410/10

MANDATORY SUPPLY MANAGEMENT: A DAIRY POLICY OPTION

OCES Ohio Cooperative Extension Service
The Ohio State University

Compiled by:

Robert E. Jacobson
Extension Agricultural Economist
and Professor, Agricultural Economics
and Rural Sociology Department, OSU

OSU

For Sale Publication

10/86 - 1M
Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture, J. Michael Sprott, Director of the Ohio Cooperative Extension Service, The Ohio State University.

Mandatory Supply Management - A Dairy Policy Option

Introduction

The prospect of a continuing supply-demand imbalance, still lower support prices, and an ongoing erosion of dairy farmer equity are prompting renewed interest in mandatory supply-management as a solution to the dairy industry's dilemma.

Mandatory supply management or quota programs are not new. They were proposed in the 1930s, the early 1960s, and again in the early 1970s during periods when excessive milk supplies depressed milk prices and farm incomes. Since then, both Canada, and more recently, the European Common Market, have adopted this form of market regulation. In the United States, we have historically chosen other options, but the issue appears to be before us again.

The Milk Diversion Program and the Dairy Termination Program were recent attempts at voluntary supply-management, in that dairymen could opt to participate or not to participate in these programs. The diversion program produced a very short-lived reduction in the national milk supply, but milk production rebounded almost immediately after the end of the program in April 1985. Although it is still too early to judge the final outcome of the Dairy Termination Program, it will undoubtedly have a longer-term impact than the diversion program. There appears to be much skepticism among industry leaders, however, as to how effective the program will be in curtailing production beyond 1987.

Thus, the two ends of the policy spectrum that will be confronting the industry are: should milk prices be allowed to continue to fall until production adjusts to bring supply and demand into balance, or should the industry adopt a mandatory supply control program that would limit each producer to a share of the national market, under some form of market quota allocation.

In order to assist dairymen and industry leaders in understanding and evaluating the present dairy policy options, we have prepared a seven-letter series that will attempt to review in a brief, but factual manner, what mandatory supply-management involves, some examples of existing programs, and lessons we can learn from them. Additionally, this series looks at how a proposed U.S. quota program might be structured, and how it might impact on various segments of the industry.

Our aim is to provide a factual and unbiased overview of supply management as a policy option, with particular emphasis on mandatory supply control programs since that seems to be where the interest currently lies.

****

Series Titles & Authors:

Editors:

Harry M. Kaiser, Cornell University
Walter C. Wasserman, Cornell University
Wendy J. Barrett, Cornell University

Inquiries concerning this letter series should be addressed to Harry M. Kaiser, Department of Agricultural Economics, 304 Warren Hall, Cornell University, Ithaca, NY 14853-7801, (607)255-1598

1 Mandatory Supply Management - A Dairy Policy Option

WHY THE CURRENT INTEREST IN SUPPLY MANAGEMENT?

Walter C. Wasserman, Cornell University

Over the last six years the dairy industry has been plagued with an overwhelming supply-demand imbalance. Milk production has increased by 20 billion pounds from 1979 to 1985, while commercial demand has increased by only half that amount. Government purchases under the price support program rose dramatically from 2.1 billion pounds of milk equivalent in 1979 to a peak of 16.8 billion pounds in 1983, at a cost exceeding 2.5 billion dollars for the year. Record production, record USDA purchases of dairy products and record price support expenditures characterized the years from 1981 to 1983. Attempts at discouraging milk production during this period were centered primarily in the area of price support adjustments. Then from 1983-85, there was a period of policy innovation, as support price drops were combined with voluntary supply control programs in a further attempt to reduce government purchases and expenditures. Milk prices received by farmers fell $2.12/cwt between May 1981 and May 1986 after adjusting for deductions. The effective all milk price for May 1986 was $11.38/cwt, the lowest price in eight years. Dairy farmer equity has deteriorated as well and the question being raised is "What will it take to bring the dairy industry back to a long-term equilibrium condition, with milk supply and demand in reasonable balance and farm milk prices that will afford a reasonable return to labor and capital?" Some will answer that mandatory supply controls are the only option remaining, while others will argue just as vehemently that controls or quotas are not the answer.

Dairy Policy Review 1982-85

At the beginning of 1982, support prices were established in accordance with the Agriculture and Food Act of 1981. This Act specified a support price of $13.10 (at 3.67% fat test) through September 1982 and $13.25 from October 1982 through September 1983, unless support purchases or expenditures dropped to specified levels which would trigger higher prices based on 70 or 75 percent of parity. The inadequacy of this policy became obvious almost immediately and the search began for an alternative.

In late August 1982, Congress passed legislation changing support policy under the Omnibus Reconciliation Act. This Act attempted to reconcile the differences between advocates of a simple cut in the support price (e.g., the administration) and those who favored a more complex plan involving a two-tiered base-excess pricing scheme (e.g., National Milk Producers Federation). Congress froze the support price at $13.10 through September 1984 and gave the Secretary authority to directly assess producers up to one dollar per hundredweight (in two 50-cent increments), provided projected price support purchases did not fall below certain levels. Opposition to this modified price support program came from all segments of the dairy industry and all around the country, despite the fact that the program reduced the farmers' effective price less than most of the alternatives.

This general dissatisfaction with the existing legislation led to passage of the Dairy Production and Stabilization Act (DPSA) in the fall of 1983. The DPSA initiated a set of program changes and a sequence of events without precedent. The DPSA combined four major actions. First, it lowered the support price by $.50 per hundredweight as of December 1983, and it authorized further reductions of 50 cents/cwt in April and July of 1985. Second, it authorized a direct assessment of $.50/cwt against all farm marketings of milk from December 1, 1983 through March 31, 1985. Third, it offered payments of $10.00/cwt of milk "diverted" to farmers who agreed to sell less milk in 1984 and the first quarter of 1985 than they did during a base period. Fourth, all farmers were required to contribute 15 cents/cwt of milk marketed to a National Dairy Promotion and Research Program, although credits of up to $.10/cwt were allowed for contributions to similar regional or statewide programs.

The Milk Diversion Program, as it was known, was successful in reducing 1984 milk production by 4 billion pounds and government purchases under the price support program by 8 billion pounds, but its success was short lived. Milk production began to increase sharply as soon as the program terminated in March 1985,

culminating in another record year. U.S. milk production topped 143 billion pounds in 1985, and although commercial sales continued to improve, CCC purchases increased by 53%.

The 1983 farm bill expired on October 1, 1985, but Congress failed to deliver a new policy on schedule. The House and Senate conferees finally agreed on the provisions of the 1985 Farm Bill on December 14, 1985. The bill was approved by both the House and the Senate the following week and was signed into law by the President on December 23.

The "Food and Security Act of 1985" covers a period of five years, through calendar 1990. The major dairy provisions of the Act include: an $11.60 support price through December, 1986. Price supports at $11.35 from January 1 to September 30, 1987 and at $11.10 on October 1, 1987. On January 1, 1988 and every January thereafter, the support price may be reduced by 50 cents if net removals by the government are projected to exceed 5 billion pounds. In addition, the bill authorized the Secretary of Agriculture to initiate a Dairy Termination Program by April 1, 1986. The objective of the program was to reduce milk production by 12 billion pounds. Producers submitted bids which, if accepted, provided them with a payment in return for ceasing milk production for a five-year period. The bill also provided for an assessment of 40 cents per cwt on all milk as of April 1, 1986 and a reduced assessment of 25 cents per cwt from January 1 to September 30, 1987. Additionally, there were provisions that raised Class I differentials in 35 Federal Order markets, provided for the establishment of a national dairy commission, and addressed a number of other dairy concerns.

The DTP was successful in retiring 12.28 billion pounds or 8.7% of the milk marketed in 1985, thus fullfilling its primary goal. Our preliminary projections indicate that the program will have a positive impact in reducing milk supplies and increasing farm milk prices during the summer and fall of 1986 and 1987. The greatest uncertainty pertains to the period 1988-90, at which time the current legislation falls back on the disincentive of lower price supports to curtail supply-demand imbalances. There seems to be great skepticism among some segments of the industry that these provisions will be able to sustain a balanced market.

The Supply-Demand-Price Outlook

At the present time, indications are that the current dairy policy and market conditions are in fact bringing supply and demand into better balance.

In July, U.S. milk production declined by 1% from year earlier levels following increases of up to 7% during the first quarter of the year. Milk cow numbers continued to decline for the seventh consecutive month, reflecting the DTP and dairy price policy. July cow numbers were down 2.3% from July, 1985.

Even more significant in the long run is a 6% decline in the number of dairy replacements on farms on July 1. By the end of July, 642,000 dairy cattle had been removed from farms under the DTP.

Commercial disappearance (sales) has continued to increase dramatically. For the first six months of 1986, commercial disappearance increased 4.2% compared to the same period in 1985. Lower milk production, moderate increases in commercial sales and sharply lower government purchases are forecast for 1987.

U.S. Supply and Use of Milk

	1983	1984	1985	1986*	1987**
Production	139.7	135.4	143.7	145.1	142.0
Farm Use	2.4	3.1	2.6	2.3	2.3
Marketings	137.3	132.3	141.1	142.8	139.7
Beg. Comm. Stocks	4.6	5.2	4.9	4.6	5.1
Imports	2.6	2.7	2.8	2.9	2.8
TOTAL	144.5	140.2	148.8	150.3	147.6
Comm. Dis.	122.5	126.7	131.0	134.8	137.0
End. Comm. Stocks	5.2	4.9	4.6	4.8	5.2
Net Removals	16.8	8.6	13.2	10.7	5.4
TOTAL	144.5	140.2	148.8	150.3	147.6
Farm Price					
All Milk	$13.57	$13.45	$12.73	$12.25	$12.30
NY-NJ Blend	$13.23	$13.03	$12.32	$11.98	$12.00
Avg. Annual Assessment	$ .48	.50	.13	.36	.19
Eff. Price	$12.75	$12.53	$12.19	$11.62	$11.81

1986 adjusted for DTP & G-R-H (through September 30, 1986).
*Projected.
**Forecast.

There are a number of factors, however, that could lead to a deterioration of these favorable market conditions by 1988. Low feed prices and/or the introduction of bGH could stimulate greater production increases, particularly as milk prices strengthen while weakness in the economy could curtail further growth in demand.

The continuing threat of still lower support prices leading to further price instability and low returns to dairymen is fueling the interest in mandatory supply control as a dairy policy option.

2 Mandatory Supply Management - A Dairy Policy Option

ALTERNATIVE VOLUNTARY SUPPLY MANAGEMENT POLICIES FOR THE DAIRY INDUSTRY

Harry M. Kaiser, Cornell University

This educational series is primarily concerned with analyzing the range of mandatory quota programs as alternatives to current dairy policy. However, it is important to recognize that mandatory quotas are not the only type of supply management program available for "managing" our milk supply. To add a broader perspective of the concept of supply management to this series of publications, this article describes the general notion of supply management, and several forms of voluntary supply management programs that have been proposed for national dairy policy over the last several decades.

What are Supply Management Programs?

Interest in supply management almost always develops when supply begins to outpace demand. In order to bring demand and supply into balance, policy prescriptions tend to emphasize supply rather than demand adjustments, with producer finance promotion programs as an exception to this rule. The reason for this is simple. Demand for milk is quite stable--easy to forecast, but difficult to alter in the short run. It is hard to increase demand because of the difficulty in changing consumers' tastes, preferences and habits. Supply, on the other hand, can be controlled more readily through government programs that offer producers economic incentives (or disincentives) to encourage a desired level of production. By offering producers incentives, or disincentives, the government can adjust production to be more in line with consumption. In the past, U.S. dairy policy has always resorted to voluntary supply management programs or adjustments in prices to control production.

Although the term "supply management" has been used frequently in recent discussions about alternative dairy policies, it is difficult to find a standard definition of what this phrase means. The term has come to mean different things to different people. For example, some have used it synonymously with specific programs like the Milk Diversion Program, Dairy Termination Program, or milk quotas. Others have interpreted supply management more generally to mean any policy designed to balance supply with prevailing demand. The more popular definition of supply management is supply control.

An important distinction between alternative types of supply management programs is whether producer participation is voluntary or compulsory. Voluntary programs seek to adjust total production in relation to projected consumption by providing economic incentives to dairy farmers for voluntarily cutting back or ceasing production. Because they are not compulsory, these programs must make the incentives strong enough to encourage a sufficient number of farmers to participate in order to bring supply into adjustment with demand.

Mandatory programs (e.g., quotas) seek to limit total production by penalizing those who produce in excess of their assigned bases. Penalties have to be severe enough to discourage the majority of farmers from exceeding their quotas, ranging in severity from receiving a lower price to no price at all on any milk sold over one's quota. The effects of a quota plan on income and production depends on the period on which quotas are based, how frequently they are adjusted, and whether they are transferable.

While voluntary programs have been implemented in the past to reduce milk production, a national compulsory program has never been established in the U.S. One reason is that mandatory programs would be a radical departure from past and current dairy policies that allow farmers complete freedom in determining how much to produce.

Alternative Voluntary Supply Management Programs

Over the past 20 years, several voluntary programs have been proposed and some adopted in an attempt to reduce surpluses in milk production. One common element of all these programs is the fact that they were designed to work with (as opposed to being a replacement for) the two principal U.S. dairy programs: Price Support Program (PSP) and Federal Milk Marketing Order Program (FMMOP). Generally speaking, the PSP indirectly supports the price of milk

through government purchases of butter, nonfat dry milk, and cheese to enable manufacturers to pay the support price for milk purchased from farmers. The FMMOP promotes "orderly" marketing conditions by requiring milk handlers to pay farmers minimum prices for fluid eligible milk depending upon how the milk is used. The proceeds are then pooled in the market and farmers receive a uniform or blend price. The following are some of the voluntary programs that have been proposed to operate in conjunction with the FMMOP and PSP.

Class I Base Plans: Class I base plans were authorized for Federal Milk Marketing Orders in 1965. These programs are sometimes called two-tiered pricing programs because farmers receive different class prices (rather than a blend price) on fluid base and over fluid base milk marketings. If adopted in a marketing order, all farmers are assigned an annual Class I base, which is equal to the market percentage of Class I (fluid) sales multiplied by their base marketings. All milk sold up to one's base receives the Class I price and all milk sold over this base receives the Class II (manufacturing) price. Farmers have incentives to reduce the amount of milk they sell under this program because the weighted average price becomes higher the more one reduces milk marketings. Since the 1965 legislation allowed Class I base to be bought and sold, farmers wishing to expand or increase the average price they received could purchase additional quotas from other farmers. In the 1981 farm bill, authorization for Class I plans was discontinued because of a lack of interest in the program by dairy farmers (only two marketing orders, Puget Sound and Georgia, had approved them).

Voluntary Quota Program (VQP): Although never enacted, VQPs were seriously considered in the early 1960s as a form of supply management. Under this program, producers would be assigned a base, similar to mandatory quotas, but would not be directly penalized if they chose to produce in excess of their base. Instead, economic incentives would be offered to farmers to cut back production by guaranteeing them a higher price on a percent of their marketings if they stay within their base. The cost of the program would presumably be offset by a reduction in the support price for milk. As a result, prices would fall somewhat for producers not participating in the program due to the reduction in the support price. This program is quite similar to the Deficiency Payment Program for wheat and corn, which provides income payments to farmers in return for reducing plantings by a specified percent below their acreage bases. One reason why this program was never enacted was the high budgetary costs predicted for the VQP.

Milk Diversion Program (MDP): The 1984-85 MDP offered direct payments to those producers who agreed to reduce their marketings from 5% to 30% below their established base. In return for their reductions, participants were paid $10 per hundredweight on all diverted milk. Participants had the option of reducing milk marketings by cow culling, decreasing cow numbers, feeding less, or increasing the farm use of milk. Because it is not very difficult for a participant in such programs to increase production in a short period of time after the program expires, supplies are likely to rebound almost immediately after the program is terminated. This is what happened in 1985, when the MDP expired.

Whole Herd Buyout Program (WHBP): The 1986 program provides for payments to farmers who voluntarily agree to cease producing milk for five years. Under the Dairy Termination Program, which it is formally called, farmers were invited to submit bids on how much the government would have to pay them to quit producing milk over this five-year period and the government either accepted or rejected each producer's bid. If a farmer's bid was accepted, he or she was required to dispose of all dairy cattle by export or slaughter and remain out of dairying for five years. WHBP's are probably more effective in reducing production than MDP's because participants have to completely stop producing milk. Unlike MDP's, the problem of a swift rebound in production after the WHBP expires is reduced because it is difficult and costly to return to milk production after being out of the business for five years.

When production gets out of line with demand, the use of voluntary supply management programs can be an effective way to adjust milk supplies. Recent U.S. experiences with the MDP and the DTP have shown that this form of supply management has been able to reduce production relative to what it would have been under no program. The main advantage of voluntary programs is that they place less restrictions on individual producers and, if designed properly, they may be relatively inexpensive in terms of government expenditures.

One potential problem with voluntary programs is that they may cause milk shortages in certain regions of the U.S. For example, under the MDP, the southern regions of the U.S. experienced a relatively high degree of participation. Milk for fluid use from other regions had to be shipped to these states at higher prices in order to satisfy regional demand by consumers. The same pattern is emerging due to the DTP. This represents a problem because it causes a misallocation of resources and especially hits milk handlers in these areas.

3 Mandatory Supply Management - A Dairy Policy Option

THE CANADIAN MILK QUOTA SYSTEM

Fred C. Webster, University of Vermont

In Canada, milk utilized in manufacturing dairy products is regulated by a national quota program and milk used in fluid products is subject to separate provincial quotas. Canada opted for a national quota program in 1970 although some of the provincial fluid programs were instituted prior to 1970. This leaflet looks at the Canadian system of milk quotas.

Conditions Leading to the Canadian Quota Program

Milk production and marketing from farms in Canada has changed drastically in this century. As the industry developed, farms near the cities concentrated on supplying fresh, fluid milk needs and more distant farms produced milk for storable dairy products.

However, the regular daily demand for fresh, high-quality milk in fluid markets made for unstable prices and frequent marketing changes as processors sought extra supplies to cover shortages or limited their milk receipts to avoid a surplus. Also, increases in productivity per cow and per farm meant that fewer farms were needed to supply the market. Market uncertainty meant high risk for investment in the modern dairy production facilities needed to make use of new technology.

In response to these problems, the Canadian Dairy Commission (CDC) was established in 1967 to oversee a supply management program for the dairy industry. Today, quotas appear to be strongly supported by the Canadian dairy industry.

Components of the Canadian Program

As in the U.S., the Canadian milk marketing system divides milk according to use as fluid milk and industrial milk (for use in manufactured dairy products). Farmers may or may not belong to a cooperative but they all have to pay a hauling charge for getting their milk to a receiving plant and each pays part of the cost of the price support program through assessments.

Beyond that, the system is far different. For one thing, Canada is a federation of large provinces--each with a great deal more independence than individual states in the U.S. Due to their size and geography, no milk for fluid use moves between provinces. Also, milk marketing quotas to control production, prices for each class of milk, rules covering transfer of quotas, and assessments to cover program costs are set by each province--not the federal government.

The supply management effort is coordinated by the Canadian Milk Supply Management Committee (CMSMC). The Committee is made up of representatives of provincial producer marketing boards, provincial government agencies, and the CDC. All major policy issues are normally set by unanimous consent of all the provinces, usually after being discussed at two meetings of the committee.

Canadian dairy farmers receive two quotas--one for fluid and one for MSQ (market-sharing quota) of industrial or manufacturing milk. Fluid quotas are determined by each province based on estimates of its fluid needs. Industrial milk needs are estimated nationally by the CMSMC and the MSQ allocated to each province on an historical basis. The provinces, in turn, allocate fluid quotas and MSQ among producers. Market share or MSQ is expressed as kilograms of butterfat. If supply or demand changes sharply, the kilograms of quota may be adjusted up or down on a proportional basis.

The responsibility for exporting dairy products that are surplus to domestic requirements rests with the CDC. Since world market prices of dairy products are highly subsidized in most cases, the disposal costs incurred by the CDC are met through levies on all producer shipments of industrial milk. The CDC determines the anticipated costs of surplus disposal prior to each new dairy year and, after discussion with the CDSMC, sets the levies required to defray the anticipated costs.

Both within-quota and over-quota levies are used. *The within-quota levy* is needed to cover the cost of exporting skim milk powder and to defray surplus removal costs of product made from within-quota milk not needed to meet Canadian requirements. *The over-quota levy* is set at a level high enough to market surplus whole milk products on world markets. It is this over-quota levy which makes supply management effective,

because it is so high that it discourages most producers from over-supplying their market shares.

The policies used to administer the market sharing quota system vary from province to province but must conform with the provisions of the national plan. For example, in Ontario the provincial allotment of market sharing quota was initially divided among all the producers in accordance with their manufacturing milk shipments in a base period.

While MSQ is an annual quota, fluid quota is set on a daily basis. Both are transferable among producers. Producers wishing to buy or sell MSQ or fluid quota submit their offers by a computer-operated quota exchange. Volumes and prices of quota submitted by potential buyers and sellers are matched. All transfers must take place over the exchange, except for within-family transfers and transfers involving ongoing farm operations. Both used and unused MSQ can be transferred, but not loaned or rented. With the exception of within-family transfers, transfers of quota are subject to an assessment of 15%.

Producers must market at least 85% of their quota. A producer marketing less than this amount may have his quota reduced unless he sells the amount of quota subject to reduction. The purpose of the maintenance requirement is to encourage high utilization of quota within the Province, and to ensure that producers will not short the market.

Experience with the Canadian Program

It is difficult to separate the results of supply management in Canada from other features of the industry. During the 15 years under this system, substantial changes have occurred in the structure of the Canadian Industry. Dairy farm numbers have dropped by some 92,000 or 67%. Total production has remained relatively unchanged and is presently in the order of 16-17 billion pounds a year. Herd size has about doubled while milk production per farm has tripled.

Structural Changes in the Producing Sector of the Canadian Dairy Industry--1970 to 1985

Year	Milk shipments	Dairy farms	Shipments per dairy farm	Average herd size
	Bil. lbs.	Thous.	Pounds	Cows
1970	16.8	136.8	122,920	18
1975	16.0	84.3	189,350	24
1980	16.3	56.4	289,113	31
1985	16.5	44.6	369,289	38

Source: Statistics Canada, Canadian Dairy Commission.

One way to compare returns to Canadian farmers with their U.S. cousins is to look at recent returns for a well-managed, actual Ontario farm. This farm was slightly above average size (for Ontario) and had nearly its maximum quota (Ontario Dairy Board policies limit quota per farm). The farm had an annual quota of 373,517 pounds fluid milk (1,023 lbs./day) and 226,761 pounds of MSQ (about 621 lbs./day). To match production with quota, the owner followed a careful culling program geared to the farm's quota, not just the productivity of individual cows.

This farmer received Canadian $23.13/cwt for fluid milk and Canadian $18.06/cwt for industrial milk in 1985. Total milk marketed was over quota by 8,080 pounds. The average price, including federal subsidy and deducting various levies was Canadian $19.81/cwt or about U.S. $13.86/cwt. After allowance for hauling, milk promotion, and other fees, the average price was Canadian $18.56/cwt or U.S. $12.99/cwt. During the same period, the "all milk" price to U.S. farmers was 39 cents lower ($12.60/cwt after adjustment for government price support assessments).

Investment in quota can be estimated by the rate at which it has sold on the quota exchange operated by the Ontario Milk Marketing Board. Recent prices are about U.S. $28/cwt or U.S. $4,200 for a 15,000 pound cow's annual production. Obviously, this is more than the total value of one year of milk production and represents over one-third of the total capital needed to operate an Ontario dairy farm.

With supply management, supplies (except for nonfat dry milk) have been kept reasonably close to market requirements. Costs to the government have been reduced by controlling supply, raising milk prices, and levying assessments on milk marketed by dairy farmers. Although net farm milk prices in Canada are slightly higher than U.S. averages, Canadian farmers have sharply higher investments in their farms because of the quota value. Also Canadian farmers must manage production closely: under production may mean loss of quota; milk sold over quota nets little more than the hauling cost.

Supply management has not stopped farms from exiting the dairy industry. In fact, the sale value of quotas may have encouraged some farmers to cash in their assets. Restrictions on quota sales to family-sized operations in some provinces may have limited the development of very large milk production units. The Canadian system provides some valuable lessons, but would not adapt easily to U.S. conditions.

4 Mandatory Supply Management - A Dairy Policy Option

THE EUROPEAN COMMUNITY'S MILK QUOTA SYSTEM

Bernard F. Stanton, Cornell University

The ten countries of the EC, excluding Spain and Portugal who have just joined, constitute the world's largest producing and consuming block for milk and dairy products. With 280 million consumers and 25 million cows, the EC is the dominant force in world markets for dairy products. The size and importance of the dairy sector in the EC is hard for most Americans to appreciate. It accounts for 20% of the value of agricultural production in the Community and affects more farmers (1.6 million) than any other product. Because milk production consistently outpaced consumption between 1975 and 1984, the EC adopted a mandatory quota program in 1984 to curtail what had become the largest dairy surplus in the world.

Conditions Leading to the EC Quota Program

The adoption of a mandatory quota system for milk production in EC-10 on April 2, 1984, occurred because earlier, less stringent efforts to bring supply into balance with demand had failed. Between 1973-75, supply was roughly in balance with domestic consumption plus exports at 80-83 million metric tons. By 1983, production had climbed to nearly 104 million metric tons (about 213 billion pounds) while consumption and exports together remained relatively constant at 82 million metric tons. A surplus approaching 20% of production resulted.

The EC Commission's first new initiatives to balance supply with demand began in 1977 with enactment of a producer co-responsibility levy. A flat rate deduction of 2.5% of the target price from all producers' milk deliveries to dairies was used to help pay for disposal and promotional programs. In 1979, 1980, and 1981, the Commission proposed a super-levy to be applied to milk delivered in excess of defined base quantities, but none of these proposals were accepted by the Council of Ministers. Meanwhile, the size of the surplus continued to grow and the costs of the program to the Community escalated even with a 3% cut in guaranteed prices to producers in 1982. The Commission in September 1983 estimated that in order to offset just the added cost likely to arise if existing guaranteed prices continued, the milk price for 1984-85 would have to be decreased by 12%. Based on much discussion, the current quota program was adopted six months later.

One reason why it was so difficult to get political support to use reductions in producers' prices to try to balance supply with demand is the structure of the dairy industry in the 10 countries of the EC, and the requirement that any change in legislation requires a unanimous vote in the Council of Ministers. In the EC, 73% of all dairy farms had less than 20 cows in 1983 and accounted for nearly one-third of total production. In the U.S., 42% of the farms had less than 20 cows but accounted for only 5% of production in 1982. Politically, small dairy producers of the EC are much more powerful; their net incomes are low and many are located in disadvantaged areas. It is this large group of more than one million farmers with low incomes who provided the final impetus for the acceptance of a quota system.

Components of the EC Program

The Community in 1984 consisted of 10 sovereign nations, each with its own Ministry of Agriculture and its own set of government institutions. This necessitated that guaranteed Community total quantities or base marketings be first divided among the 10 nations. Each nation was then given the responsibility to divide up the national base either directly to individual farms or to dairies receiving milk from farmers.

1. According to the Commission of the EC, the basic concept was an ..."annual guaranteed total quantity of milk for the Community as a whole, corresponding in principle to the quantity of cows' milk delivered to dairies and other undertakings treating or processing milk in 1981 plus 1%." Exceptions to this basic rule were made for Ireland and Italy, who were allowed to use 1983 marketings as their guaranteed bases. Most member states chose to base the determination of reference quantities for producers (production bases) on the 1983 calendar year adjusted downward by the appropriate percentage.

2. The quota system is applicable to all deliveries of cows' milk for 5 consecutive years beginning April 1, 1984.
3. The flat-rate co-responsibility levy was continued and increased to 3% for the 1984-85 marketing year.
4. A "Community reserve" was established to allow member states some latitude in solving local problems in assigning quotas and facilitating the change-over during the first two years.
5. Separate quota arrangements were established for producers who sold directly to consumers based on their 1981 sales plus 1%.
6. After reference quantities (quotas) were fixed for individual producers for a 12-month period, individual producers were liable for a super-levy of 75% of the target price for all production in excess of their respective reference quantities. When the reference quantities were fixed for dairies receiving milk, this levy was set at 100% of the target price for any excess marketings. Each individual country was required to enforce collection of the super-levy.
7. Provision was made for individual countries to establish a national reserve to provide some flexibility for special circumstances when initially allocating individual quotas.
8. Reference quantities granted to purchasers or producers delivering to purchasers or selling direct to consumers are not freely transferable or saleable. The only exceptions are when a farm is sold, leased or transferred by inheritance. Member states may provide that a part of the quota so transferred be added to the national reserve. Essentially, quotas go with the farm or agricultural holding and become a part of the property rights associated with it.
9. Individual countries have the right to allocate reference quota to producers out of their national reserves to handle special situations or to permit structural change.
10. Several countries offer additional voluntary programs to encourage smaller and older dairymen to cease production. While such programs differ by country, they essentially offer one or more annual payments to qualifying producers to stop milk production.

All milk delivered by producers whether as whole milk, cream or manufactured on the farm into dairy products is subject to the quota program. State farms, experimental programs, and all types of production units come under the jurisdiction of the program. If cream is separated and sold, the milk equivalent comes under the mandate of the EC program.

Experience with the EC Program

The quota program completed its first year of operation in April 1985. In 1983, milk deliveries for EC-10 had amounted to 103.7 million metric tons. In the transition year 1984-85, the guaranteed total for the Community was set at 99.024 million tons. In 1985-86 and subsequent years, the production base was 98.152 million tons. The required reductions or changes in the first year that quotas were imposed amounted to more than 4% of marketings for the Community as a whole. In some countries like the United Kingdom and the Netherlands reductions of more than 9 and 8% were required, respectively.

The imposition of quotas halted the steady increase in milk production in the EC in 1984-85, and at the end of the second year, April 1986, the guaranteed total of 98.177 million tons was essentially met. The size of the penalty for over-quota deliveries has been a strong deterrent to additional production by individual producers. Thus, the gap between production and consumption in all forms plus commercial exports has been stabilized. There remains a difference of more than 12 million metric tons between consumption at 86 million and quota production of 98 million.

With a very large and complex system to administer, involving 10 quite different member states, the EC Commission is quite hopeful about the operational strength of the new program. A report to the Council of Ministers is required on the operation of the levy system and the program at the end of the 1986-87 operating year. It is too early to know how effective the social and political pressure among participating countries has been in enforcement of all the elements of the program. The very existence of the Common Market concept requires strict adherence to the rules and mandates as promulgated. National governments are responsible for administration and reporting on a regular basis to the Commission.

The allocation of the global quota to 10 countries essentially freezes the proportions of Community production into the pattern of 1981. Because quotas are tied to farms or agricultural holdings within countries, except for portions acquired in national reserves, patterns of production within countries are essentially fixed at least over the five years of the program to April 1990.

It is too early to draw many conclusions about the new system or its performance. Production was reduced in the first year very nearly as targeted. A substantial gap between production and consumption remains despite the quota. Not much friction has arisen as yet because quotas are not freely transferable.

5 Mandatory Supply Management - A Dairy Policy Option

THE CALIFORNIA MILK QUOTA SYSTEM

Edward V. Jesse, University of Wisconsin-Madison

While a national mandatory quota program has never been adopted in the U.S., California, the second leading dairy state, operates a quota program for fluid milk. It is very different from the quota systems in Canada and the EC in that the California plan applies solely to milk sold for fluid products.

The California program uses quotas to assign marketing rights to the higher-priced fluid market. Producers are paid different uniform or blend prices depending on their production relative to individual *quotas* and *production bases.*

Conditions Leading to the California Quota Program

Prior to 1968, California Grade A or market milk producers contracted with plants for specific volumes of milk. Administered pricing in effect in California since the 1930s, set higher minimum prices for fluid milk, so producers contracting with plants having high fluid utilization fared well compared to neighbors with identical quality milk who contracted with low-utilization plants. Competition was considerable among producers for contracts with high fluid utilization plants, who held the upper hand in negotiating non-price contract terms like hauling rates.

To address equity problems in allocating fluid milk sales among eligible producers, the California Legislature passed the Gonsalves Milk Pooling Act in 1967. Under the Act, which became effective in late 1968, each licensed market milk producer was assigned a *production base* and a *Class I quota.* These were based on daily average milk sales during either 1966 or 1967. Because California has used component pricing for milk sales since 1972, the production base was total fat and solids-not-fat (SNF) sales expressed on a daily basis. Class I quota was fat and SNF sales under contract to fluid handlers.

Due to widely-varying fluid sales opportunities under the contract system, quota as a proportion of production base differed substantially among market milk producers. To rectify these differences, 80 percent of any increase in Class I quota was to be allocated to existing producers according to their quota/production base ratio, with the remainder going to new entrants. Hence, as increases in fluid sales occurred, additional Class I quota was granted to market milk producers in inverse proportion to their ratio of quota to base. The intent was to "equalize" all market milk producers at a ratio of 95 percent.

To speed the process, a blanket allocation of new quota was made in 1978 to equalize all producers holding production bases at that time. This brought the total amount of quota well above the amount needed to meet fluid milk requirements, a situation that persists today.

Components of the California Program

California milk quotas and bases do not restrict total milk production, but producers receive different prices for quota, base, and overbase milk. At the state level, these prices depend on how much of total producer milk is used in each of four utilization classes: fluid (Class I), soft products (Class II), ice cream/frozen products (Class III), and hard products (Class IV). Quota milk is assigned to the highest (i.e., most valuable) use class for pricing purposes. Overbase milk, which is milk production in excess of production bases, is assigned to the lowest class. Base milk, which is production base minus quota, is assigned to the residual classes.

This procedure sounds very complex so an example will help clarify how farm milk prices are calculated. Suppose California milk use by class for some month is as follows:

Utilization Class	*Price*	*Percent Used*
1	$13.00	45
2	12.00	7
3	11.50	5
4	11.00	43
		100

Now, suppose producer marketings for the same month are distributed as follows:

Quota Class	*Percent of Marketings*
Quota	50
Base	20
Overbase	30
	100

Then, the prices for quota, base, and overbase milk would be calculated as follows:

$$\text{Quota Price: } \frac{(45\% \times \$13) + (5\% \times \$12)}{50\%} = \$12.90$$

$$\text{Overbase Price: } \frac{(30\% \times \$11)}{30\%} = \$11.00$$

$$\text{Base Price: } \frac{(2\% \times \$12) + (5\% \times \$11.50) + (13\% \times \$11)}{20\%} = \$11.23$$

In other words, the quota price is calculated by starting from the top down in terms of allocating milk value. The overbase price is calculated by starting from the bottom up. What's left over is allocated to base milk to establish its value.

These prices for quota, base, and overbase milk would be the same for all market milk producers at the same location and with comparable milk quality and composition. But the blend price received by a producer would depend on how much of the producer's milk fell into the three categories. A producer whose milk composition was 90 percent quota milk and 10 percent base milk would receive $12.73 per hundredweight in the above example (.9 x $12.90 + .1 x $11.23). A producer with 50 percent quota milk, 20 percent base milk, and 30 percent overbase milk would receive $12.00.

Similar to the Canadian program, quotas may be traded among California market milk producers. Quota sales are expressed in dollars per pound of SNF per day. Prices vary with several factors, including the number of pounds of quota fat per pound of SNF (normally around 0.4 pounds but different among producers), the amount of production base tied to the quota, and whether cows are sold along with the quota.

However, the most important factor affecting quota prices is the difference in value between quota and overbase milk. This value difference becomes capitalized in quota prices. For example, the difference in price between quota and overbase milk in May 1986 was $1.70 per hundredweight (based on average fat and SNF composition). The average price for quota transfers in May 1966 (quota price without cows) was $276 per pound of SNF per day. At 8.7 pounds of SNF per hundredweight of milk, this translates to a cost of $2,400 per hundred-weight of whole milk per day. In other words, the investment necessary to obtain $620.50 in added milk revenue per year ($1.70 x 365 days) was $2,400.00. That reflects a 26 percent annual rate of return. At the $276 per pound of SNF quota cost, it would have cost about $1,000 to purchase quota equivalent to the average daily SNF production of one dairy cow producing 15,000 pounds of milk per year.

Experience with the California Program

Unlike federal order blend pricing, the California system provides a price incentive for individual producers to control production. Under federal order pricing, all production is priced at the marketwide blend price. In contrast, production in excess of a California producer's production base is priced at the overbase price. If the overbase price is below marginal production costs, then the California producer would be induced to cut back to production base levels.

However, compared to the Canadian and EC programs, California's overbase milk price is quite high. The price for milk sold over-quota in Canada was equivalent to only 11 percent of their price support in the 1985-86 marketing year. In Europe, the price received for over-quota milk is 25 percent of the price support. In recent years, the dairy price support program has yielded a price for overbase milk that has been high enough to cause a substantial increase in California milk production, much of which has been sold to the Commodity Credit Corporation as butter, powder, and cheese. In the 1984-85 marketing year (October - September), California was the leading state in Commodity Credit Corporation sales of butter and nonfat dry milk; third in cheese. Thus the California quota system has not balanced milk supply with demand.

For some time, California producers have found it profitable to expand production of overbase milk, even though the overbase price has been below the federal support price. For instance, in May 1986, the California overbase price (average fat and SNF composition and prices) was $10.66 per hundredweight. The comparable support price in the same month was $11.31, and the M-W price (average Grade B price in Minnesota and Wisconsin) was $10.98.

6 Mandatory Supply Management - A Dairy Policy Option

Components and Implications of a U.S. Mandatory Quota System

Robert P. Story, Cornell University

Mandatory supply management programs involve the use of some type of production or marketing allotment or quota. The programs are mandatory because they are applied to all producers of a specified commodity and not just to those producers who individually elect to participate in such programs.

National dairy pricing programs in the United States have never included mandatory supply controls. Supply controls have been an important element in the debate that has surrounded the formulation of national dairy pricing policy. In this leaflet, the features and impacts of a national quota program are investigated.

Existing Dairy Price Programs

Price support has been the key element of dairy price policy from its beginning in the 1920s. Price support has been achieved primarily through the purchase of dairy products by the government, although voluntary supply management programs have supplemented purchase programs on several occasions.

During the 1930s, purchases of dairy products to support milk prices were very modest, exceeding one billion pounds of milk equivalent in only one year. Since 1949 purchases have been made each year to support market prices. Market prices were maintained near support levels throughout the 1950s and '60s. Since the 1970s, market prices have deviated more (both up and down from support levels) than in the earlier periods.

Support purchases exceeded 10 billion pounds of milk equivalent in 1954, 1962, 1981, 1982, 1983 and 1985. These peaks in support purchases triggered legislation that modified the dairy support program and stimulated debate of alternatives to the program. Mandatory supply management was an important element in the debate following each peak in support purchases, particularly in the 1960s and 1980s.

Features of a Mandatory Supply Management Program

A mandatory supply management program is a production control program in which all dairy farmers would be assigned a base, and there would be a substantial *penalty* price for marketings of over-base milk. Federal legislation would be necessary to adopt such a plan. Neither states nor dairy cooperatives have the ability to address the national supply-demand-price issue with their own versions of base plans.

There are two fundamental purposes that a national quota program would be directed to achieving: (1) to balance supply and demand, and if possible, at a price level high enough to permit "average" dairy farmers to enjoy a satisfactory level of living; and (2) to permit dairy farmers to hold onto "their" individual share of the total milk market and not have the expansion of other dairy farmers reduce the price level and dilute their market share.

Supply management has a solid economic foundation, geared to the principle that the demand for some dairy products (particularly fluid milk procducts) is price inelastic. That is, consumers do not respond in any substantial measure to whether prices go up or down--they still will purchase close to the same amount of dairy products. By restricting supply, milk prices can be increased, and yet demand will not be adversely affected in any major way. The net results is higher producer income.

Mandatory supply management could reduce the costs of the current price support program and alleviate problems of storage and disposition of dairy products. Given probable program costs and budget restraints, mandatory quotas may receive greater consideration in the future.

Most features of the current price support program would be continued with a quota program. A target price would need to be established each year and a purchase program for dairy products would continue to be necessary. Distribution programs would be needed to utilize dairy products that were acquired under the program. Other additions to the current program would include:

1. Procedures for establishing a national quota and for allocating the national quota to individual dairy farmers.

2. An over-quota price and procedures for determining it would need to be established.
3. Rules for transferring and reallocating quotas would be needed.

These features of a quota program could be accomplished in a variety of ways. The details of these features would affect the effectiveness and the impact of the program. The following illustrates how these features might be determined.

Establishment of Quotas

A national milk quota might be determined by estimating the total commercial demand for milk and adding the quantity of milk needed for domestic and international distribution programs. A reserve might be added to this total.

The national quota might be allocated to individual producers by relating it to the quantity of milk marketed by farmers in a designated base period. This base might be a 12-month period or the annual average of a longer period. If the annual national quota was 90% of total marketings by producers in the base period, the quota allocated to individual producers would be 90% of each producer's marketings during the base period. The national quotas could be reduced gradually over a period of years from near the base period level to a level that would balance milk supplied closely with total market needs. Gradual reduction would increase program costs.

Over-Quota Prices

For the program to be effective in curbing the expansion of milk production or cutting it back, the over-quota price would need to be low enough to discourage over-quota production. A low over-quota price would be needed to finance the purchase and disposition of dairy products associated with over-quota milk. The penalty for over-quota milk in the EC program is 75% of the target price. Under the Canadian program, the over-quota price was only 11% of the quota price for the 1985-86 marketing year.

Quota Transfer Rules

Quotas could be freely transferable or saleable with or without geographic limitations. Transfer could be highly restricted as in the EC program where transfer of quotas is permitted only when a farm is sold, leased or transferred by inheritance. Sale or lease of annual quota rights might be permitted without authorizing the sale of quotas themselves. A wide difference between quota and over-quota price would give quotas or annual quota rights significant value if they were saleable. Both the Canadian and EC programs take back a portion of the quota whenever quotas are transferred. The acquired quota could be allocated to new or existing farms to facilitate expansion. Quota rules could require producers to fulfill a specified percentage of their quotas monthly. If they failed to do so the unfilled quota could be taken from them and transferred to other producers. Permitting the sale of annual quota rights would help to insure that the national quota would be filled each year and would serve to limit over-quota sales.

Impacts of Mandatory Supply Management

The impacts of a quota program would depend importantly on the details of the program and whether it was temporary or permanent. Since a specific program has not been proposed, only general observations can be made about the impacts of a quota program at this time.

Use of quotas could maintain milk supplies in closer balance with demand over time. More particularly, the periodic large surpluses that have characterized the dairy industry could be avoided. Government program costs could be reduced in part by shifting these costs to milk producers through assessments and to consumers through higher prices for milk/dairy products.

If transfer of bases were restricted, existing resource patterns would be frozen, innovation retarded and productivity gains limited. This would not be a serious problem if the program was temporary and used to eliminate an existing surplus problem. Quotas would have little market value under these circumstances even though the over-quota penalty is large.

If quotas were freely transferable or saleable and the program was not temporary, the quota would have considerable value, particularly if the penalty for over-quota milk was large. The annual value of the quota would be capitalized over future years under these circumstances. The value of the national quota under the Canadian program in 1983 was estimated at more than $2,800 per cow.

If there were equally profitable alternative uses of the dairy farm, the quota could be sold separately from the farm without subtracting from the sale value of the farm. If profitable alternative uses of a dairy farm were limited, the sale of the quota separately from the farm would subtract an almost equal amount from the value of the farm. Therefore, in some cases, the sale of quotas would result in a large windfall to the seller but in other cases it would not. The incentive to sell quota separate from the farm would be greater in areas with profitable alternatives to dairy farming.

7 Mandatory Supply Management - A Dairy Policy Option

Farm and Market Level Consequences of Supply Management Programs

Robert E. Jacobson, Ohio State University

As the previous leaflets have suggested, U.S. programs have always managed the supply of milk through the price mechanism. Our objective was to gain some kind of a reasonable supply-demand balance, and the support price was adjusted up or down depending on whether milk was expected to be in short supply or in surplus. But in the 1980s, the milk industry has been confronted with chronic surpluses that are larger and more costly than most people are willing to accept. Embryo transplants, bovine growth hormone, iso-acid supplements and a number of other technological breakthroughs suggest that there will be increasing supplies of milk at relatively low costs. As a result, increasing attention is being directed to a mandatory supply management approach. Given the background of the previous leaflets, this seventh and final article examines the farm and market level implications of a mandatory supply management program.

Farm Implications

Probably the stickiest elements of a mandatory supply management program come down to who holds title to the base and what kind of base transfer rules are in place. Farm-level implications vary depending on how such rules are defined. For example, is title to base held by the dairy farmer (Canada) or is it assigned to the farm (Europe)? Can bases be transferred among dairy farmers (Canada), or is base transfer not permitted (U.S.--whole herd buyout base)? The usual view of supply management reflects the Canadian approach--bases assigned to the dairy farmer, and transferable.

A frequently voiced objective of dairy price policy is to "save the family dairy farm". Supply management has been promoted as a method to accomplish that purpose. But the Canadian version of supply management has neither slowed nor stopped the trend to fewer and larger dairy farms. In the past decade, the number of dairy farms in Canada has declined by 44%, while the number of farms with milk cows in the United States has dropped by only 35%.

The Canadian experience does not mean, however, that supply management will not help save the family dairy farm. Part of the reason for Canada's continued dairy farm concentration is found in their rules for base transfer. Title to base is held by the milk producer, and he is free to sell his base or to purchase additional base from other milk producers. The net effect of these provisions has tended to encourage some producers to sell out and others to get larger.

If we were to adopt a base plan in this country, we would not have to follow Canada's path. We could establish rules in which the government essentially holds title to the base, and no base transfer among producers would be permitted. The government would allocate base and reallocate base by prescribed rules. The base of a retiring producer would revert to the government. Such arrangements could slow the trend to fewer and larger dairy farms.

Assuming base transferability, bases take on substantial value because they represent a privilege to market milk and to receive a significantly higher price for the base amount of milk. Therefore, the value of base becomes an asset in the farm balance sheet and an additional cost in the schedule of production costs. With a supply management program, with its price and quantity specifications at the farm level, questions arise concerning the impacts on milk production efficiency and resource allocation. Without supply management, it is assumed that competitive market equilibrium prices adjust resources and encourage efficient milk production. If bases are transferable under a supply management program, most of the questions concerning milk production efficiency and economic resource allocation are resolved. Dairy farmers would buy base to expand and sell base as they retire in many instances. The question of allocating base to new producers must be addressed, but it poses no major problems if the total market is increasing. Knowing that the amount of milk that they can market at a desired price is fixed by the base, milk producers would shift their decision-making emphasis from that of growth and expansion to that of cost minimization for the quantity they can market.

If bases are not transferable, the efficiency questions become more critical. Higher cost pro-

ducers would have very little incentive to exit from dairying and, in effect, would be subsidized by the higher base price. Adoption of new technology would be slowed, and the entire industry would be less competitive. The burden of fine tuning the quota program in ways that would continue to invite progress and efficiency would be in the hands of government.

Regionalization would emerge as a major consideration in the adoption of a supply management program. Historically, the use of Commodity Credit Corporation purchases of butter, cheese, and nonfat dry milk to support the price of producer milk has permitted us to view dairy price support as a single national program without significant regional ramifications. But mandatory supply management would force a change in that view. For example, Class I utilization ranges from less than 20% in the upper midwest to higher than 80% in the southeast. If a quota program provided for a uniform cutback in supply across the nation, some areas would be short of fluid milk supplies while other areas would be affected very little. We have already observed some regional supply problems in the voluntary diversion and whole herd buyout programs. Mandatory supply management would force regional differentiation.

Market Implications

Most of the market implications of a mandatory supply management program are geared to the higher price level that the program would establish. While the demand for milk may be price inelastic, it still responds negatively to higher price levels. The milk industry in the U.S. has enjoyed a remarkable increase in commercial demand in the 1980s, and it is reaching a new record of 135 billion pounds in 1986. Some of that demand vigor is explained by the 15-cent/cwt promotion assessment, and some of it is explained by relatively low retail prices for milk and dairy products. Higher prices could dampen the recent strength in commercial demand and remind us again of the continuing substitution issue confronting the milk industry.

Since mandatory supply management could essentially be programmed to balance supply with demand, the problem with dairy surpluses would virtually disappear. Government purchases of dairy products would occur only on a seasonal or sporadic basis, depending on what the program authorized. As a result, the costs of the dairy program, which have been in the $2 billion a year range in most of the 1980s, would be reduced to minimal levels.

Many dairy cooperatives would face major operating adjustments under mandatory supply management. Dairy cooperatives have built milk manufacturing facilities on a large scale over the years to undergird their bargaining purposes and to guarantee their members a market. An estimated 77% of producer milk in the U.S. is marketed through cooperatives. When the manufacturing facilities are running near capacity, which is the case in periods of excess milk supply, the manufacturing facilities generally are in a breakeven to a profit-making situation. A mandatory supply management program that could effectively reduce supplies would lead to a situation of some excess capacity, higher operating costs, and lower savings for farmer members.

Competition for producer milk would intensify with mandatory supply management. Producers would find new pricing and hauling incentives to switch sales outlets and memberships. One effect of the competition would be to boost producer prices above the prices stipulated in the base program. Also, dairy cooperatives would find themselves in a stronger position to bargain for higher over-order premiums. The strong upward pressures on producer prices that a supply management program would generate could mean that the program would have to incorporate price ceilings as well as price minimums in order to serve the public interest.

A last market implication that should be recognized is that a tight supply-demand situation brought on by a base program could invite increased imports of dairy products. In 1973 and 1974, import quotas were relaxed substantially when milk production dropped abruptly and markets were short of milk. A supply management program cannot be managed or administered perfectly and additional imports could be required again to assure adequate supplies.

Finally, a word about the politics of supply management is appropriate. It will never go anywhere in Federal legislation until a large majority of milk producers clearly indicate that a mandatory base plan is what they want. If a vote were taken today, it is not clear that 67% or even 51% of the dairy farmers in this country would support mandatory bases. The difference among dairy farmers would be everywhere--between neighbors, between dairy cooperatives, and between regions. Beyond that, Congress has its doubts, and the current Administration has already drawn its line--**NO**. So we are looking at a program that is three to five years away at best.

A quota program is a serious alternative. Our challenge is to further evaluate its long-term benefits and costs in formulating a dairy price policy that effectively serves its objectives. We should look closely at all the aspects of this approach before we leap.