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# Dairy Update

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**ECONOMIC ISSUES AND IMPLICATIONS OF A  
 NATIONAL MANDATORY MILK QUOTA PROGRAM**

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NOTE: This information was abstracted from an article appearing in the June, 1987 Journal of Dairy Science entitled "Economic Issues and Implications of a United States Milk Quota Program." This 7-page article, with 14 pertinent references, was authored by Harry M. Kaiser, Department of Agricultural Economics, Cornell University, Ithaca, NY 14853.

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## INTRODUCTION

Topics debated frequently among industry leaders are the advantages and disadvantages of a mandatory quota program. The fear is that the problems of the 1980's will persist if current programs aren't changed. These problems include:

1. surplus of milk supplies far beyond demand;
2. cost of removing these surpluses through the dairy price support program;
3. declining milk prices;
4. lower income and less equity for dairy farmers; and
5. limited effectiveness of "voluntary" programs such as the diversion and herd buyout programs.

In any effective quota program, each dairy farmer would be given the right to market certain quantities and milk, and penalized for either selling over or under the assigned quantity.

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## DIFFERENCES BETWEEN CURRENT POLICY AND QUOTA PROGRAMS

Under past and current policy, farmers are free to sell as much milk as they want. For the 30-year period preceding 1890, the Dairy Price Support Program (DPSP) was relatively successful in balancing supply with demand. In that 30-year period, the average annual cost unadjusted for inflation was \$250 million. Between 1980 and 1986, the average annual cost of the DPSP was \$1.94 billion, a 7.8-fold increase.

The two fundamental objectives of a mandatory quota program are:

1. to balance supply and demand without reducing prices; and
2. to permit farmers to maintain their individual market share and not have the expansion of others reduce the price level and erode their share of the market.

## COMPONENTS OF A MANDATORY QUOTA PLAN

1. Under any quota plan, each producer is assigned a quota based on actual milk deliveries for a specified period (typically one year or an average of several previous years). Hardship allowances should be made to farmers that experienced special circumstances.
2. A marketing certificate would be issued each year to ensure the producer his or her share of the national quota allotment. This procedure guarantees total milk supplies will not exceed expected demand.
3. A two-tiered pricing system would be utilized to discourage over-quota production. The over-quota price must be much lower than quota milk in order to limit production. Over-quota milk in the Canadian and European quota programs average about 20% of the price for quota production.
4. Minimum production might be imposed to ensure against seasonal shortages of milk. In some quota plans, producers that fail to produce minimal allocations may lose some of their certified quota the next year.
5. While it is assumed that quotas could be sold or given to other members of the family, a decision would have to be made as to whether quotas could be bought and sold separately from the farm. Further, it must be determined whether quotas could be transferred between states or only within states or marketing areas.

Producers desiring to expand deliveries because of either more milk per cow or more cows could either accept a lower over-quota price or purchase additional quotas. These quotas (or marketing rights) acquire considerable value over time. Generally speaking, quotas become more valuable when:

- a) profitability of milk production relative to other farming enterprises increases;

- b) the penalty on excess deliveries becomes greater;
- c) the amount of annual quota declines;
- d) total milk production on the farm increases; and
- e) availability of quotas to be purchased declines.

For instance, in the Ontario province (Canada) where quotas may be bought and sold between farms, quota values average about \$28.00/cwt (in U.S. money), worth about \$210,000 in a 50-cow farm averaging 15,000 lb milk/cow/year.

6. The relationship between a mandatory quota program and existing Federal Milk Market Order (FMMO) programs would have to be considered. One way to set up a rational program would be to superimpose the quota system on FMMO (grade-A) producers. The price support for manufacturing grade milk could be replaced with the quota price, which presumably would be higher. Milk handlers would continue to pay for their milk on a use basis. Over-quota milk sold would receive the lower over-quota price. Handlers would be required to pay the difference to an administrative fund between quota and over-quota price on excess milk purchased. The revenue collected by this fund could be used to pay administrative costs and disposal of any surplus that might still exist.

#### **SOME OBSTACLES IN FORMULATING A QUOTA PLAN**

A mandatory quota program will require legislation to be enacted by Congress and signed by the President. Furthermore, it may require a two-thirds approval by all dairy farmers in a special referendum. Key obstacles in drafting a quota program include how quotas will be allotted among regions and states.

1. Producers know that their own situation can improve or worsen according to the size of the economic pie allocated to their respective region.
2. If the government allocated quotas based on the previous year's actual production and then made the appropriate reduction in marketing by an equal percent across all states:
  - a) how would variations among states in participation in the 1984-85 milk diversion and 1986 herd reduction programs be handled? It is probably states with a high sign-up (Minnesota) would oppose this plan since total production was reduced during these years.
  - b) states that produce less milk than they consume (not the case in Minnesota) would oppose this plan because they would have to cut back on quota milk even though they are short of supplies locally.
3. Any mandatory quota plan requiring surplus regions to cut production back more than milk deficit regions would be opposed by producers in the surplus regions (Minnesota).

The three items listed above could be key stumbling blocks in getting a bill through Congress or obtaining majority approval among all dairy farmers.

Several other important issues must be resolved.

4. Quota prices would have to be increased above current support levels before farmers would accept a program that requires them to cut back on milk sales. Furthermore, milk producers would hope such a plan would increase their profitability. On the other hand, consumer advocates will undoubtedly oppose an increase in the price of milk.
5. Because manufactured milk products are more price elastic than fluid milk, a quota plan that raises manufacturing milk price too high could significantly reduce the total demand for milk. This would penalize areas (Minnesota) that produce a lot of manufactured milk products.
6. Perhaps the most difficult problem faced by those favoring a quota plan is to formulate "transfer rules" for milk quotas. Rules could range:
  - a) from being quite flexible -- marketing rights could be sold to anyone in the U.S.;
  - b) to being extremely rigid -- quotas are "lent" to farmers and become government property upon retirement.

Plan A permits original owners to obtain "windfall" gains. New producers would have to pay for them in order to enter dairying, which many policy makers believe is unfair.

On the other hand, plan B makes it difficult for milk producers to expand, makes the industry less efficient because it freezes existing production patterns, and ignores changes in comparative advantage among regions or changes in regional demands.

## ECONOMIC IMPLICATIONS

1. Milk producers are likely to receive a higher price for their milk if they remain within their quotas. The net impact on each producer would depend on whether the decrease in production exceeded the gain due to higher prices. Certainly this will vary among farms.
2. Windfall gains could be quite substantial if quotas are freely transferable. One study suggests this could amount to as much as one-fourth of the price of milk.
3. Quotas may become valuable assets and some producers may opt to sell them and retire from dairying. For example, the number of dairy farms in Canada between 1970 and 1985 fell by 64%. This compares to a 57% decline in U.S. dairy farms during the same time period.

4. Competition for available milk supplies would most likely intensify among processors during periods of short supply. Milk handlers might be forced to pay premiums or subsidize hauling rates. Bargaining cooperatives would probably be stronger and better able to obtain premiums for their members' milk.
5. A program that tightens supply also forces the industry to confront the problems of excess processing capacity. Not all would survive. There may be a painful period of transition, especially in rural communities.
6. A tight situation of supply and demand could lead to the relaxation of import controls. This happened in 1973 and 1974.
7. Higher retail prices would induce new product development for milk substitutes.
8. And finally, once in place, a quota program would be very difficult and costly to dismantle. An excellent case in point is the U.S. tobacco quota program. It is politically difficult for the government to eliminate the tobacco quota program without compensation.

## CONCLUSION

The chances for the adoption of a mandatory quota program may depend on the effectiveness of current dairy legislation. It is quite possible the impact of the current herd buyout program and the adjustments in milk price supports from 1988 to 1990, which are based on the amount of milk in the Dairy Price Support Program, will bring supply into balance with demand. If this happens, chances of enactment of a mandatory quota program will decrease. However, if milk surpluses and support program costs continue at present levels, quota programs and other alternatives will likely be considered by both the government and dairy industry leaders.