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Marketing Information for Minnesota Dairy Farmers

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# The Dairy Price Support Program

The United States government supports dairy farm income through the dairy price support program. Operating through the Commodity Credit Corporation (CCC), the U.S. Department of Agriculture (USDA) props the wholesale markets for butter, nonfat dry milk, and cheese by offering to buy surpluses of these products at prices it announces. This has the effect of supporting the entire dairy price structure since milk used in other products such as cottage cheese, ice cream, evaporated milk, or fluid products potentially can be shifted to the supported products. The announced purchase prices for butter, cheese, and nonfat dry milk are calculated to permit processors to pay dairy farmers the support price for their milk. This fact sheet provides background on the program, describes its operation, and considers its effectiveness.

## LEGAL BASIS FOR THE PROGRAM

The present price support program is authorized by the Agricultural Act of 1949. These are the three main guidelines for operation of the program:

- It provides for minimum and maximum levels at which farm milk prices are to be supported—75 to 90 percent of parity* (the 1977 Act raised the minimum to 80 percent of parity until March 31, 1979, when it reverts to 75 percent of parity unless extended by new legislation).
- It provides only general guidelines for determining the specific support level. These include "assure an adequate supply" of milk, reflect changes in production costs, and assure a level of farm income to maintain productive capacity to meet future milk needs.
- It specifies that the program shall be conducted through purchases of milk and milk products.

In addition, the level of price support must be announced at the beginning of the marketing year (October 1). The support price level may be raised during the marketing year, but it cannot drop below the level announced at the October 1 start of the year.

Recent changes in the program include shifting the beginning date of the marketing year from April 1 to October 1 so that the price support decision would be shifted to a better time for evaluation of the national feed supply. The 1977 farm act, in addition to raising the minimum support price to 80 percent of parity, provided for 6 month (April) adjustments in the support price to reflect changes in the prices of farm inputs. Previously, the price support level was set annually.

*Basically, parity is the calculated price which would give 100 pounds of milk the same purchasing power in terms of the things farmers buy as it did in 1910-1914. Parity also takes into account how the price of milk, during the most recent 10-year period, compared with other prices received by farmers.

## SETTING PRICE SUPPORT RATES

Two complicated sets of calculations must be made by USDA in carrying out the program.

1. The parity objective is translated into a price per hundred pounds of manufacturing milk. For example, on September 29, 1978, it was announced that prices for the year beginning October 1, 1978, would be supported at 80 percent of parity which was $9.87 per hundred for manufacturing milk at the national average milkfat test of 3.67 percent. The present support price for manufacturing milk is related to the purchasing power of milk during the 1910-14 base period, taking into account the relationship between dairy prices and other agricultural commodity prices over the past 10 years. The entire parity calculation method is spelled out by law and administrative procedures.

2. The support price of milk ($9.87 per hundred pounds in the following illustration) must be translated into buying prices for butter, nonfat dry milk, and cheese. The calculation considers the amount of products that can be produced from 100 pounds of milk and costs of processing it. The calculations for the year beginning October 1, 1978, were as follows:

*Butter-nonfat dry milk calculations:*

| | |
|---|---|
| 100 pounds of milk yields | |
| 4.48 lbs of butter @ $1.113 per lb | $ 4.99 |
| 8.13 lbs of nonfat @ $.7375 per lb | 6.00 |
| Total market value per 100 lbs of milk | $10.99 |
| Plant margin allowance per 100 lbs of milk | 1.12 |
| Value above plant margin allowance | 9.87 |

*Cheese calculations:*

| | |
|---|---|
| 100 pounds of milk yields | |
| 10.1 lbs of cheese @ $1.06 per lb | $10.71 |
| Whey and whey fat value | .43 |
| Total market value per 100 lbs of milk | $11.14 |
| Plant margin allowance per 100 lbs of milk | 1.27 |
| Value above plant margin allowance | 9.87 |

The calculations for both cheese and butter-nonfat dry milk are designed to enable the plants to pay producers the $9.87 support price. However, they must achieve average levels of plant efficiency in both product yields and processing costs and, in addition, must be able to sell these products at the announced wholesale prices if they are to have the necessary funds available. It should be noted that individual plants are not required by law to pay producers the price support level, rather the method relies on competition between plants to lead to the desired average level of producers' pay price.

## EFFECTIVENESS OF THE PROGRAM

As a way of supporting prices received by farmers, the program has generally worked quite well. However, with the rapid inflation of recent years, the performance has not been as good as in earlier years when prices were more stable.

There have been periods when dairy prices were significantly below the support level. This has tended to occur immediately following a raise in the support level and during the peak production months when supplies of the price supported products are comparatively heavy and plants are operating close to capacity. In 1977, the problem was particularly serious. The monthly U.S. average price of manufacturing milk adjusted for fat test was below the support price from April through November of that year. In April-June, the manufacturing milk price averaged 26 cents below the support price. It was generally believed that a major cause of the problem was that cheese plants were not prepared to ship cheese to CCC in the form CCC specified and in the quantity necessary to bolster the wholesale cheese market. The cheese market tended to stay below the support price by about 3 cents per pound (equal to some 33 cents per hundredweight of milk). In addition, there were some indications of inadequate processing capacity in some locations and possibly inadequate plant processing allowances.

The price of manufacturing milk again fell short of the support level by 3 to 12 cents during the April-July 1978 period.

Overall, from 1968-1978, the U.S. average monthly price for manufacturing milk was below the support level an average 1 of every 4 months or 25 percent of the time.

On an annual average basis, the record was better since months when the price was above the support level offset some of the months when it was below. Apparently there is some disagreement as to what the law requires. Some say it calls for month by month support, while others say that it refers to the annual average price.

## CCC PURCHASES AND COSTS

The amount of products removed from the market by CCC over the past 10 years equaled about 3.5 percent of the milk marketed by U.S. farmers. However, there was considerable year-to-year variation in the CCC removals which was generally associated with changes in the amount of milk produced. The peak in the past 10 years came in 1971 when CCC purchased about 25 percent of U.S. butter production, over 30 percent of nonfat dry milk production, and about 6 percent of American cheese production. Overall, purchases in 1971 accounted for an equivalent of 6 percent of the milk marketed by farmers. Removals in 1977 were also large, accounting for about 5 percent of the milk marketed. The low point over the past 10 years was 1976, when only about 1 percent of milk marketed by farmers was removed from the commercial market.

CCC incurs certain costs in operating the program. The major cost is the value of the price-supported commodities. In addition, there are storage, handling, and sometimes packaging costs. Offsetting somewhat are occasional sales of the commodities by CCC back to the trade or to other outlets when market prices rise to sell-back levels.

Net government expenditures on dairy support programs have averaged about $320 million over the same 10 years. This does not include administrative costs. The high was $714 million during the 1976-77 fiscal year, and the low was about $71 million during the 1973-74 fiscal year. Expenditures under the special milk program averaged about $100 million per year, in addition to the price support programs. The special milk program increases milk consumption by children in schools and child care centers.

## USE OF CCC SUPPLIES

Having acquired stocks of butter, cheese, and nonfat dry milk, CCC must dispose of them in a useful manner. From time to time, CCC is able to sell back to the commercial trade when wholesale prices rise above support prices by a specified amount. However, even when these opportunities arise, only small quantities are involved. It is mostly a matter of trying to channel products into consumption without displacing regular commercial sales.

The major outlet for CCC-owned butter and cheese is the school lunch program. Other outlets include VA hospitals, but these are small compared to the school lunch program. In earlier years, the direct commodity distribution programs to needy people absorbed a considerable quantity of CCC dairy products. This program was largely discontinued in favor of the food stamp program and no longer offers a significant outlet for CCC stocks. Foreign donations of butter and cheese do not offer much potential, although during periods of heavy surplus, CCC has converted butter to butter oil for foreign distribution.

Domestic outlets for CCC stocks of nonfat dry milk were also affected by the shift away from direct commodity distribution to the needy. The school lunch program is able to take only a limited amount of nonfat dry milk. CCC places major reliance on donation to foreign outlets as a means of disposing of nonfat dry milk. These are generally made under the P.L. 408 program, but other means are also used.

## EVALUATION OF THE PROGRAM

Like any program, the dairy price support program has strengths and weaknesses. Some working strengths of the program are said to be:

- the price objectives under the program are reached with a fair amount of precision;
- it is less disturbing to commercial interests than other programs might be because it operates through established market channels and agencies;
- it is a price stabilizing as well as a price supporting program.

Stable prices are more conducive to effective planning by dairy farmers than are widely fluctuating prices and generally more acceptable to consumers. Some say that weaknesses might be:

- the higher consumer prices necessitated under the program have caused consumers to purchase fewer dairy products;
- the program uses tax dollars and at times has been quite costly;
- disposing of surplus stocks in a useful way has become increasingly difficult.

## SUMMARY

How to balance off the various strengths and weaknesses in order to form an opinion on the program is a matter of individual choice. But, careful study and evaluation of the program, as well as possible alternatives, are necessary for an effective dairy program.

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