Impact of Federal Dairy Legislation on the Florida Dairy Industry

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I appreciate the invitation to participate in this year's Dairy Production Conference and welcome the opportunity to discuss with you the impact of Federal Dairy Legislation on the Florida dairy industry.

Obviously the present price support legislation is having a substantial impact on Florida's dairy industry. however, in discussing this subject we must look back to previous Federal legislation because the difficult situation we now find ourselves in was created in large part becuase of what we can probably now characterize as ill-advised dairy legislation that we operated under for several years, beginning in 1977.

The basic legislation establishing dairy price supports is the Agricultural Act of 1949. Under this legislation the Secretary was, until 1977, required to establish a price support level in the range of 75 to 90 percent of parity. The actual level within this range was generally left to his judgement and based on such factors as supply and demand and farmers' production costs. The important factor, however, was that there was some flexibility to adjust the actual support price from year to year based on significant economic factors.

The 1977 amendments to the Act required the Secretary to set the initial support price at 80 percent of parity and then to adjust it upwards every six months to reflect increases in the wholesale price index. As you will recall, this was a period of high inflation so the wholesale price index was moving up rapidly.

When this legislation was passed in 1977 the support price was $9.00 cwt. and government costs for the price support program in that year were $451 million (just a little above the average of the past 30 years). By October 1, 1980, just three years later, the support price had risen 45 percent and stood at $13.10. During the 1980-81 marketing year government expenditures reached nearly $2 billion.

The support price remained at the $13.10 level until the recent diversion program became effective and purchases under the price support program rose to $2.6 billion for the marketing year ending September 30, 1983. To put the seriousness of the surplus situation in perspective consider the fact that in the last marketing year the Department of Agriculture purchased 30 percent of all the butter produced in the U.S. It purchased 25 percent of all the cheese produced and 70 percent of all the nonfat powder. In terms of whole milk equivalent, the Department removed 16.6 billion pounds or about 12 percent of the nation's milk supply last year.

While Florida dairymen enjoyed reasonably high prices during most of this period, the burdensome surplus being created by this inflexible price support program began having a detrimental effect on the state's dairy industry. This is true even though throughout this period Florida's production remained inadequate to supply the state's fluid needs. Why? Because the unrealistically high prices were creating additional unneeded production in areas of the country that serve as alternative supply sources for Florida. As long as such milk was available, Florida's ability to negotiate reasonable prices was impeded. And as we all know substantial additional volumes of milk did come into Florida with a resulting depressing effect on prices.

Under normal circumstances this type of price competition would create a healthy economic climate but much of this additional supply was developed in response to artifically high price supports, and not in response to economic signals in the market place.

Congress' attempt to correct the price support problem with the so called dairy assessment legislation didn't make matters any better for Florida farmers. Rather than address the support price problem head on, it assessed all farmers in the country 50 cents cwt. - and then a few months later $1.00 cwt., on all of their production. This further reduced Florida farmers' returns but didn't cut into the surplus. Nobody liked this legislation and Congress immediately began considering alternative measures to deal with the problem. The so called "compromise" legislation that we are now operating under was the result of many months of negotiation among milk producers and with our elected representative.

Briefly, these are the principal provisions of the current legislation. (1) On December 1, 1983 the support price was reduced from $13.10 to $12.60 cwt. This support price is to be effective until September 30, 1985, except that the Secretary may reduce it another 50 cents on April 1, 1985 if CCC purchases are estimated to exceed 6 billion pounds for the succeeding 12 months. Also, he may reduce the price another 50 cents on July 1, 1985 if purchases are estimated to exceed 5 billion pounds in the succeeding 12 months; (2) the dairy farmer assessment on all milk production was set at 50 cents cwt. for the period December 1, 1983 through the end of March, 1985; (3) a milk diversion plan was implemented on January 1, 1984 which pays dairy farmers $10 cwt. to cut production in the range of 5 to 30 percent. Each producer participating in the diversion program has already signed a contract with the Secretary; (4) beginning May 1 all dairy farmers will be assessed 15 cents cwt. with the funds earmarked for advertising and promotion of milk and dairy products.

And now the important question is - how is the diversion program working and what impact will it have nationally and on the Florida dairy industry?

Nationally, the signup was not nearly as high as it was hoped. When the program was implemented there were fears that the signup would result in a national milk shortage; the legislation even gave the Secretary authority to cut all contracts if such a shortage developed. Actually only about 38,000 farmers signed up for the program. This represents less than 20 percent of the nation's commercial dairy farms. These dairy farmers contracted to divert 7.5 billion pounds of milk in 1983 or 22.9% of their base marketings of 32.8 billion pounds. However, because a number of these producers had already reduced their 1983 marketings from their base period, the actual reduction in 1984 as compared with 1983 will be less than the contracted diversions. The effective reduction from 1983 to 1984 will be around 5.3 billion pounds -- contracted diversion of 7.5 billion pounds less 2.2 billion pounds of marketings already diverted before the program started.

As you can see from these numbers, the impact on the national supply will not be nearly enough to bring the surplus down to acceptable levels. We are now estimating a reduction in the national supply of somewhere between 3 and 5 percent, which means 1984 production of around 136 billion pounds. There should be some improvement in commercial sales, which will help, but it is now clear that purchases under the price support program will remain high and will probably exceed the "trigger" levels next April 1 and July 1. As I indicated earlier, if purchases exceed these "trigger" levels the Secretary will have the authority to reduce price support 50 cents cwt. on each of those dates.

Looking at the diversion program on a regional basis shows that a larger proportion of total production is being diverted in those areas that produce a relatively small proportion of the nation's milk supply. (See attached exhibit.) These are, for the most part, the deficit areas of the country and this means they will be even shorter this year.

On the other hand, the heavy milk production areas of the ocuntry have the lowest participation rate. The Pacific, Lake States and Northeast regions are by far the heaviest milk production regions of the country, accounting for about 60 percent of the nation's milk supply. Yet, the effect of the diversion program in these regions will be relatively minor, reducing production only 3.5, 3.2 and 2.0 percent respectively, in 1984 as compared with 1983. Contrast that with the deficit southeast where the diversion program will reduce production more than 10 percent.

In Florida the diversion payment signup was the highest of all the states in the nation. Nearly half of the state's producers signed contracts with the Secretary. Only five states (California, Iowa, Texas, Minnesota and Wisconsin) will divert more milk than Florida. Even before the diversion program was implemented, Florida had the greatest milk deficit of any state in the nation and now that Florida farmers have signed up in such large numbers the situation for the coming year could be extremely critical.

As announced by the Department, 185 Florida farmers signed contracts to divert 317.2 million pounds of milk during the 15 months the diversion program will be in effect. After adjusting for cuts already made during 1983 and taking into account an estimate of the production increases by dairymen not participating in the program , it appears that Florida production will be down about 12 percent in 1984, as compared with 1983.

There is another factor that will complicate the supply situation later this year. Many of the Florida dairymen who signed up for the program did not cut their production very much, if any, during the first quarter of 1984. This means that they will have to catch up later in the year in order to meet their commitment, or face stiff penalties for not complying with their contract. They probably will do this catching up during the late summer months when supplies are the shortest and the need for imported milk is the greatest.

Taking all these factors into consideration it is clear that Florida will have a critical shortage of locally produced milk this fall. The Florida cooperatives are now estimating that they will need about 146 million pounds of additional out-of-state supplies to fulfill their processors' needs during the June - December period. Nearly 33 million additional pounds will be needed in September when school will reopen.

Now, where will all of this additional milk come from? Florida is already drawing heavily on nearby states' supplies to fill handlers' requirements. for example, in March about 49 million pounds of the total producer milk supply pooled in the three Florida orders was from producers in other states. This was more than 20 percent of the total producer supply for the month. Because of supply changes made last fall, the monthly volume of out-of-state milk associated with the three markets is far greater than in any previous year. Thus, Florida is already laying claim to large volumes of nearby supplies and we haven't yet entered the deficit season.

The problem for the coming short season months will be aggravated by the fact that the nearby states that normally serve as the primary source of supplemental milk are also participating heavily in the diversion program and it is very unlikely that there will be much milk available from these areas to make up the Florida deficit this summer and fall.

So, where will the milk come from? In the past we have looked to the upper midwest (primarily Wisconsin and Minnesota) and the northeast for limited volumes of supplemental milk. These areas are not participating in the diversion program to the extent that other areas are, so there may be additional milk available there for shipment to Florida. But that means a long haul and transportation costs are going to make it very expensive. And it is going to be difficult to get enough tankers to haul this milk all the way to Florida. It promises to be a very challenging time for the Florida dairy industry. We'll just have to wait and see whether we get through the year without any real serious problems developing.

Just a few comments on Florida's participation in the diversion program. I have been asked a number of times as to why the participation rate here was so much higher than the rest of the country. At least one of the reasons is obvious to all of us. Dairy farming in Florida has not been profitable during the past year. We have been through some serious price disruptions in the last few months and at the same time feed costs have been climbing rapidly. This depressed situation certainly has provided an incentive to participate. Another reason the participation rate was higher here is that a large proportion of dairymens' total costs in Florida are for feed, replacement cattle and labor. These costs can be reduced or eliminated by cutting production. Dairymen in the northeast and midwest grow most or all of their own feed, raise most of their replacements and have a substantial investment in machinery, silos and building. Most of these farmers intend to grow crops anyway, and most of their other costs will continue, whether they cut production or not. A third reason I believe participation was higher here is that Florida producers were well-informed about the advantages of the diversion program and were able to make their decision on the basis of this good information. Florida cooperatives did a commendable job working with their members. While some cooperatives in other areas may have done as well, I don't think that was generally true throughout the country.

The nation's dairy industry is going through some difficult times. Many observers believe we could have avoided these difficulties by not tinkering with the price support program back in the late 70's. In almost thirty years the support program had provided a safety net against disastrously low prices. At times in the past surpluses were a problem, but when they were, the Secretary had some flexibility to bring prices down and supply and demand back into reasonable balance. But as you can see, when that flexibility was taken away from him in 1977, things really got out of hand. The result has not only been mounting surpluses and high government costs, but also severe criticism of the program from the press, Congress and the general public. Whether this damage can be undone in the future remains to be seen.

One thing is clear, however; we have been reminded in a forceful way of a basic law of economics we should never again ignore. You cannot administratively set prices without taking into account what impact those prices will have on the supply of, and demand for, the product. The laws of supply and demand will work every single time. The dairy price support program was never intended as a price setting mechanism. Hopefully, the new dairy legislation to be included in next year's farm bill will bring the program back to its original purpose, which was to provide farmers with assurance that prices would not get disastrously low.