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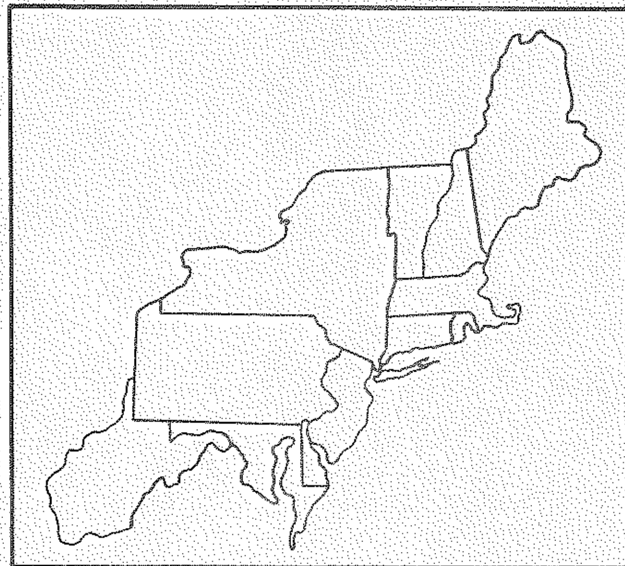

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THE CURRENT DAIRY PROBLEM AND ITS IMPACT ON NORTHEAST FARMERS

by

Richard W. Stammer*

As any research methods class would point out we must first identify if we have a problem. As has been pointed out by previous speakers we certainly do have a problem when 10% of national dairy production is being purchased by the government at an annual cost to taxpayers of over two billion dollars.

How did we get into this situation? The problem had its genesis in the Carter administration when the minimum support was set at 80% of parity - a move opposed by the National Milk Producers Federation. However, this change in the level of support price did not cause a problem until the general economy and the agricultural economy went to pieces beginning in 1980. The price support level of milk has not increased since October 1980 but production and C.C.C. purchases have continued to increase for the following reasons:

1) A poor general economy that both depressed commercial demand and practically reduced alternative opportunities for dairy farmers (i.e. selling land to developers or taking outside employment).

2) Low beef prices which resulted in farmers keeping cows that would otherwise have been culled.

3) Low grain prices which resulted in farmers feeding more grain and increasing production per cow.

4) Poor profitability in all of agriculture relative to dairy, particularly grain production, that resulted in entry of new milk producers and the shift to more dairy production on general farming operations.

5) Low net dairy farm income as a result of declining real prices and high interest rates that resulted in producers adding more cows to maintain their cash flow position. In an analysis done by Springfield Credit Banks of 539 Northeast dairy farms they found that while the average net cash income per cow has declined since 1979, net cash income per farm has remained constant since 1980. This was accomplished by adding more cows. For instance from 1981 to 1982 net cash income per cow declined 4% because expenses increased more than receipts but producers offset this by adding an average of three cows per herd.

What Is the Solution?

During this past year I have worked very closely with several other cooperatives through the National Milk Producers Federation and several Congressmen in trying to reach a solution to the problem. Many solutions have been proposed such as: cutting support prices, the .50 cent and one dollar assessment programs, two tier pricing, paid diversions, cull cow programs, farm retirement

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plans, and cutting supports and freezing Class I prices. The previous speaker described the basis of the compromise plan reached by the House and Senate leaders and the administration. However, even after that agreement was made, a new bill is going to be introduced by a New York Congressman to just cut supports $1.50.

Through this whole, often frustrating, process one soon learns that raw politics is often more important than economics. However, one must continue to use strong economic reasoning to support their position.

The major thrust of the industry effort has centered on a few major points:

1) We must address the problem.

2) Recognize that the problem occurred as the joint effect of many factors, not just the support price.

3) Find a solution that eases us out of the problem and results in a stronger more efficient dairy industry - rather than just pulling out the rug.

4) Find a solution that addresses the federal budget problem - (we must recognize that this is a crucial issue with the administration cutting social programs to address the budget deficit problem in order to maintain a tax cut and increased military expenditures).

As such, the industry preferred a paid diversion program financed by farmers to help the industry through the next two years and reduce government expenditures by approximately 1.4 billion dollars.

<u>Will The Compromise Legislation Be Effective and What Will Be the Impact On Farmers?</u>

The compromise legislation contains some elements of the National Milk Producers Federation program - namely paid diversions and a mandatory promotion assessment. The biggest problem with this program is that the paid diversion plan only runs for 15 months as compared to the 24 months proposed in the Federation Plan. We should not make the mistake of assuming that anyone viewed paid diversions as a long run solution to the problem if everything else remained constant. In a long run solution demand must be increased and supply will be cut by having fewer farms - not the same number of farms each producing less milk. However, the paid diversion program was viewed as a short run solution that would ease the transitional hardship on dairy farmers at the same time it provided a holding period for other economic factors causing the problem to correct themselves, which would yield a long run solution. Let me briefly explain: paid diversions would probably give the economic incentives for many farmers, who were considering retirement or going out of business to do so without suffering financial disaster. This orderly exit of farms would be further encouraged with improvements in the general economy and the agricultural sub-sector during this period. Another important factor to realize in assessing the probability of this long run adjustment is that farmers have maintained their net cash income in recent years by living off depreciation. This is shown by the fact, from the Springfield Bank study, that while net cash income has remained constant, average net earnings per farm have declined from $10,500 in 1980 to $850 in 1982. Farmers cannot continue to live off depreciation, and the

need to invest new capital in light of declining prices will encourage many producers to exit from production. Farmers whose long run objective was to stay in business would be able to cut production in the short run and still maintain the necessary cash flow to meet expenses. An improving economy with flat milk prices and increased input costs, particularly grain costs as a result of the P.I.K. program, should have allowed a long run solution to the problem to work itself out by the time the paid diversion program ended. I have considerable doubt as to whether the paid diversion program under the compromise legislation is long enough to allow economic forces to adjust and bring about a long run solution to the problem.

Our principal objection to just cutting prices is that it fails to recognize the many facets of the problem and may force out many efficient farmers who have high debt loads.

What Farmers Will Be Hurt By the Programs

I think that Milt Hallberg addresses this question quite well in his paper. Again the results of the Springfield Bank Study would indicate that the key factor to survival is management. While they found that, on the average, larger farms and farms with greater production per cow were more profitable; they also found many profitable smaller farms and many unprofitable large farms. Their analysis indicates a fairly low correlation between size and profitability. Again, I feel a sharp price cut will tend to hurt the farms with heavy debt loads.

One additional factor that must be considered, however, is the impact of reduced total production in the market on the actual farm price. In the Northeast, commercial outlets for milk have been expanding in recent years, particularly the Italian cheese businesses in New York. While currently 10% of the national product is sold to the government, only about 5.5% of production in the Northeast went to the government in 1982. Hence, a 10% reduction in production in the Northeast would tighten up commercial markets considerably and raise the possibility of cooperatives being able to impose over-order prices, such as we had in 1973-74, that would increase producer income. One only has to look at the Southeastern markets to recognize the impact of tight milk supplies on net producer prices even at a time of national surpluses.