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FEDERAL DAIRY PROGRAMS

Long-Term Market Solutions Needed to Solve the Surplus Problem

Statement of
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Committee on Agriculture, Nutrition and Forestry
United States Senate

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Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss our past work on dairy programs. As a result of federal policy enacted to support dairy farmers' income, there are currently high levels of dairy surpluses. My testimony today highlights federal efforts in the 1980s to control milk surpluses and on our analysis of those efforts. Under the Milk Diversion Program, dairy farmers voluntarily contracted to reduce their milk sales by 5 to 30 percent over a 15 month period. Under the Dairy Termination Program, participating farmers left dairy farming for 5 years and were paid to either slaughter or export their entire dairy herds. Furthermore, the Congress allowed the price support level to be lowered in an effort to reduce dairy surpluses.

In summary, the Milk Diversion and Dairy Termination Programs by design were temporary fixes to reduce surpluses. Although these programs succeeded on a short-term basis, we believe use of programs with only short-term effects to counterbalance periodic surplus problems are not an effective approach. Currently, production and surpluses are again high, in part because, other federal programs--milk marketing orders and price supports--continue to provide farmers incentives to produce more milk than can be sold at prevailing prices. While the price support level has declined somewhat, it has been insufficient to contain surpluses. As we have pointed out in past reports and testimony, the Congress needs to implement long-term solutions which will phase the dairy industry over time into a more market-oriented structure, such as further reducing price supports to address high surplus levels.

HISTORIC PERSPECTIVE

As you know, the objectives of the federal dairy policy are to support farmers' prices and incomes, expand consumption, ensure an adequate supply of good quality milk, and stabilize dairy prices and markets. The policy is carried out principally through two programs--the milk marketing order program, created in 1937, and a price support program, created in 1949.

Marketing orders set forth marketing practices, terms and conditions of sale, minimum prices that must be paid by dairy plants, and the distribution of financial returns among farmers. Under the price support program, the U.S. Department of Agriculture purchases, at designated prices, all quantities of butter, cheese, and nonfat dry milk that cannot be used commercially. The program stabilizes milk prices by, in effect, guaranteeing a minimum price for any amount of dairy product that can be produced. Federal outlays for the program depend upon the support price and the extent to which milk production exceeds commercial use. The more production exceeds use, the more surplus products the government buys and the greater the cost to the government.

These programs were initiated when low milk prices were perceived to threaten the stability of the nation's milk supply. Through the 1970s, the two programs were generally changed to support incomes for the farmer by increasing the price support level and establishing a national pricing system.

GOVERNMENT PROGRAMS ESTABLISHED TO CONTROL PRODUCTION

The relatively high price support levels during the late 1970s and early 1980s contributed to unprecedented milk production levels. Because the market was unable to absorb the additional production, annual purchases under the price support program dramatically increased from $251 million in 1979 to $2.6 billion in 1983. Consequently, the Congress took a series of actions during the 1980s that attempted to reduce production and thus reduce government purchases of surplus dairy products. In 1983, the government reduced the amount it would pay for surplus dairy products. In 1984 the government established the Milk Diversion Program that paid farmers to reduce the amount of milk they sold over a 15-month period. In 1985, the Congress (1) instituted a "supply/demand adjuster," which would--until 1991--automatically reduce price supports if surpluses were projected to exceed certain levels and (2) authorized the Dairy Termination Program, which paid farmers to slaughter or export their entire herds and leave dairying for 5 years. While the 1990 farm bill reauthorized the supply/demand adjuster, unlike the 1985 version, it restricts the level to which the support price can fall, which limits its value in controlling surpluses.

To aid the export of cattle under the Dairy Termination Program, bonuses were offered under the Export Enhancement Program (EEP). EEP, established in 1985, provides bonuses to U.S. exporters to help lower prices of U.S. agricultural commodities and make them competitive with subsidized foreign agricultural exports.

PRODUCTION CONTROLS HAVE HAD SHORT-TERM SUCCESS

The Milk Diversion and Dairy Termination Programs as designed have only provided short-term solutions to the dairy surplus problem. For example, we reported in July 1985 that the Milk Diversion Program had reduced milk production by about 4 billion pounds in 1984 and saved an estimated $664 million. We also reported in July 1989 that, from 1986 through 1990, the Dairy Termination Program would reduce milk production by an estimated 39.4 billion pounds and saved the government an estimated $2.4 billion. The estimates of annual milk reductions attributable to the Dairy Termination Program declined each year after 1987, because nonparticipant farmers increased production.

Our work has also shown that EEP was costly and not especially effective in aiding the export of cattle under the Dairy Termination Program. Due to the large bonuses being paid, the program did not extend beyond 1988. For example, in 1987 nearly $60 million in bonuses were paid to make the exports, but those bonuses were 121 percent of the value of the dairy cattle exported. Specifically, in June 1990 we reported on dairy cattle exports to Indonesia[1] and found that although dairy cattle exports did increase, it is unclear how much of the increase was due to EEP. Additionally, the exports were not without logistical problems. For example, we were told that the U.S. cattle were not producing as much milk as expected, were experiencing problems with impregnation, and not adapting to Indonesia's climate. Further, a September, 1989, Office of Inspector General report on the program stated that USDA did not effectively manage its dairy cattle program during initial implementation. The Inspector General's office found that USDA did not have sufficient cost data to compute bonus amounts, that they did not anticipate some of the difficulties that were encountered when exporting live animals.

[1]Indonesia benefited from the largest share of the bonuses--$18 million of the program's total of $68 million.

CURRENT CONDITIONS
OF DAIRY MARKETS

As the positive effects of these short-term programs have leveled off, large surpluses have led to increased government purchases. In addition, farm milk prices have recently declined.

Government purchases and stocks of dairy products have been increasing. As of March 1, 1991, government stocks of dairy products stood at 9.9 billion pounds of milk equivalent, a high level relative to the late 1980s, and up about 79 percent from 1990. This stock level represents about 75 percent of the 1983 amount when it reached a record high.

While farm milk prices declined slightly from 1980 to 1988, they spiked to a high of $16.00 per hundred weight as of December 1989. However, by March 1991 they had plummeted to $11.50, representing a 28 percent decrease from December 1989. Further, commercial stocks of dairy products are higher than they have been in the past 10 years. On March 1 of this year, commercial butter stocks reached a record high, and manufacturers' stocks of nonfat dry milk were the largest in 16 years. Cheese stocks were somewhat larger than last year.

LONG-TERM SOLUTIONS NEEDED

TO SOLVE CONTINUING

SURPLUS PROBLEM

Under the 1990 farm bill, the Secretary of Agriculture must provide the Congress with a report and recommendations on various inventory management programs that would help reduce dairy product surpluses. USDA published its findings in the Federal Register on May 15, 1991, and is expected to release its report with recommendations to the Congress on June 15, 1991.

While we are currently evaluating these proposals for the House and Senate agriculture committees, we have consistently recommended market-oriented solutions to address dairy management issues. In that regard, we continue to support the use of a supply-demand adjuster like the one adopted in the 1985 farm bill. Such a support price adjuster would make milk prices more responsive to market forces, thus more closely balancing production and utilization. However, past price support decreases have been insufficient to preclude large surpluses because they have not been allowed to fall to a sufficiently low level. Consequently, government purchases of surplus dairy products have been increasing. Further, the price floor in the 1990 farm bill version of the adjuster restricts the ability of the support price to fall when necessary to contain surpluses.

CONCLUSIONS

In conclusion, Mr. Chairman, we recognize that the dairy industry is being impacted by large surpluses and low prices. Although short-term solutions have provided temporary surplus reductions, as a long-term solution we continue to believe that the Congress needs to seek alternatives that allow the nation's dairy farmers to make the transition into a more market-oriented industry. Recognizing that such an approach may adversely affect the dairy industry, we believe the transition to a market orientation needs to be phased in over time.

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This concludes my formal testimony. We would be happy to respond to your questions.

RELATED GAO PRODUCTS

International Trade: Export Enhancement Program's Recent Changes and Future Role (GAO/NSIAD-90-204, June 14, 1990)

Federal Dairy Programs: Insights Into Their Past Provide Perspectives on Their Future (GAO/RCED-90-88, Feb. 28, 1990).

International Trade: Activity Under the Export Enhancement Program (GAO/NSIAD-90-59FS)

Milk Pricing: New Method for Setting Farm Milk Prices Needs to Be Developed (GAO/RCED-90-8, Nov. 3, 1989).

Dairy Termination Program: An Estimate of Its Impact and Cost-Effectiveness (GAO/RCED-89-96, July 6, 1989).

Dairy Termination Program: A Perspective on Its Participants and Milk Production (GAO/RCED-88-157, May 31, 1988).

Milk Marketing Orders: Options for Change (GAO/RCED-88-9, Mar. 21, 1988).

Federally Owned Dairy Products: Inventories and Distributions, Fiscal Years 1982-88 (GAO/RCED-88-108FS, Feb. 23, 1988).

Surplus Commodities: Temporary Emergency Food Assistance Program's Operations and Continuance (GAO/RCED-88-11, Oct. 19, 1987).

International Trade: Implementation of the Agricultural Export Enhancement Program (GAO/NSIAD-87-74BR, Mar. 17, 1987)

Overview of the Dairy Surplus Issue--Policy Options for Congressional Consideration (GAO/RCED-85-132, Sept. 18, 1985).

Effects and Administration of the 1984 Milk Diversion Program (GAO/RCED-85-126, July 29, 1985).

Alternatives to Reduce Dairy Surpluses (CED-80-88, July 21, 1980).

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