

STATEMENT OF ALICE M. RIVLIN
DIRECTOR, CONGRESSIONAL BUDGET OFFICE
BEFORE THE DAIRY AND POULTRY SUBCOMMITTEE
COMMITTEE ON AGRICULTURE
U.S. HOUSE OF REPRESENTATIVES

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There should be no release of this
statement before its delivery,
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11, 1979

Mr. Chairman:

I am happy to be with you today to discuss alternative minimum price support levels for milk. This is a major agricultural policy issue since the decision will influence the availability and price of milk and other dairy products to consumers, the incomes of dairy farmers, and federal budget outlays. The issue is also timely since the increase in the minimum support level from 75 percent of parity to 80 percent, as stipulated in the 1977 Food and Agriculture Act, recently expired. If the Congress does not legislate an alternative price level before October 1, 1979, the Secretary of Agriculture will have the discretion to select a support price between 75 and 90 percent of parity.

The immediate question facing the Subcommittee is: At what level should the minimum price support for milk be set? To assist the Subcommittee in resolving this question, the Congressional Budget Office has prepared a report that reviews government regulation of milk pricing and analyzes in depth four alternative price support options. In my statement today, I will summarize the conclusions of this report on two major subjects:

- o First, the historical consequences of dairy price support policy; and,
- o Second, the likely effects of alternative minimum levels of price support on dairy farmers, consumers, and the federal budget.

HISTORICAL CONSEQUENCES OF THE DAIRY PRICE SUPPORT PROGRAM

Within the overall milk pricing system, the dairy price support program establishes a floor under milk prices which often influences the level of milk prices and the incomes received by all dairy farmers. To prevent market prices of milk from falling below the support price, the federal government purchases manufactured dairy products through the Commodity Credit Corporation (CCC). For the 1950-1975 period, it is estimated that the milk prices received by farmers were approximately 7 percent higher than they would have been without a dairy price support program and that annual consumer expenditures for dairy products were about \$400 million higher. Federal budget outlays for CCC purchases of dairy products have averaged about \$250 million a year over this period, representing approximately 4 percent of annual milk production. In recent years, however, budget outlays have been high and quite volatile: in fiscal year 1977, they reached a record \$710 million; in fiscal year 1978, they declined to \$450 million; and in fiscal year 1979, they are projected to be \$300 to \$400 million.

The dairy price support program has had both benefits and costs. On the benefit side, the program has protected consumers against shortages of fluid milk and manufactured dairy products, primarily by stabilizing milk prices. That is, CCC purchases reduce the likelihood that production gluts

and low milk prices will induce dairy farmers to liquidate their herds, thereby causing production shortfalls and high prices. Historical evidence suggests that most price stability benefits have been attained when CCC purchases fell to between 2 and 4 percent of annual milk production. There is no evidence of additional price stability when CCC purchases were greater than 4 percent of annual milk production.

Another benefit is that some dairy farmers have used the additional cash receipts and greater price stability resulting from the dairy price support program to increase their capital investment and their efficiency in producing milk. The increase in capital investment and efficiency has resulted in a trend toward fewer, larger, and highly specialized dairy farms. Today, the 58,000 largest dairy farms, which constitute about 14 percent of all dairy farms, receive slightly more than 50 percent of total cash receipts from the sale of milk.

The dairy price support program has had two major costs: first, consumer prices have at times risen above the minimum level necessary to provide adequate supplies of milk; and second, federal government outlays to purchase manufactured dairy products have been significant. Another negative effect, although far less important, is that higher prices at the farm level have allowed some relatively inefficient dairy farmers to remain in business.

ALTERNATIVE FUTURE PRICE SUPPORT LEVELS

As this Subcommittee debates future milk prices, it is important to keep in mind that there is a minimum level of price support that will provide adequate price stability without increasing consumer prices excessively. Price supports above the minimum level serve to increase farm income, but they do so at the expense of higher consumer prices and greater federal budget outlays. While a redistribution of income from consumers and taxpayers to farmers may be justified, such an effect should be differentiated from the primary program objective of providing an adequate supply of milk to meet the current and future needs of consumers.

In the CBO analysis of the effects of milk price supports over the next five years, four alternative support levels—75, 80, 85, and 90 percent of parity—are considered. The major conclusion of this analysis is that adequate supplies of milk will be attained with the support price at 80 percent of parity. Somewhat greater risks of price instability and interruptions in supply result at 75 percent of parity, but little additional price stability is gained at price support levels above 80 percent of parity.

According to our analysis, for each five percentage point increase in the level of price supports, average annual cash receipts to the dairy farmer from the sale of milk increase by about \$1 billion. Consumers pay \$700

million of the increase in higher prices, and taxpayers pay \$300 million in budget outlays for the purchase of surplus dairy products.

The detailed results of our analysis of the four alternative support levels are as follows (see Table 1):

90 Percent of Parity. If the minimum support price is set at 90 percent of parity for the next five years, annual cash receipts from the sale of milk would average about \$20.1 billion, and annual retail spending for dairy products would average \$38.7 billion. As compared with the current 80 percent of parity, cash receipts would, on average, be \$2 billion a year higher. In the final year of the projection period--October 1, 1983 to September 30, 1984--retail prices would be 5 percent higher than under 80 percent of parity. Total consumer spending would also be up \$1.4 billion a year, even though higher prices would reduce consumption of dairy products by nearly 2 percent.

Setting the minimum support price of milk at 90 percent of parity would cause annual CCC purchases to rise dramatically, from 4 billion pounds in 1979 to 10 billion pounds in 1983 (see Figure 1). These amounts far exceed the minimum CCC purchases that in the past have been needed for price stability. Budget outlays at 90 percent of parity would average \$1.3 billion annually, or about \$700 million more per year than at 80 percent of parity.

TABLE 1. AVERAGE ANNUAL VALUES OF SELECTED VARIABLES FOR THE PROJECTION PERIOD, 1979 TO 1983 a/

	75 Percent of Parity	80 Percent of Parity	85 Percent of Parity	90 Percent of Parity
Total Cash Receipts (billions of dollars) <u>b/</u>	17.1	18.0	19.0	20.1
Consumer Expenditures (billions of dollars) <u>c/</u>	36.7	37.3	38.0	38.7
Net Support Outlays (millions of dollars) <u>d/</u>	251.0	568.0	898.0	1,290.0

a/ The projection period consists of five marketing years beginning October 1, 1979, and ending September 30, 1984.

b/ Obtained by multiplying the all-milk price times the quantity of milk sold by farmers.

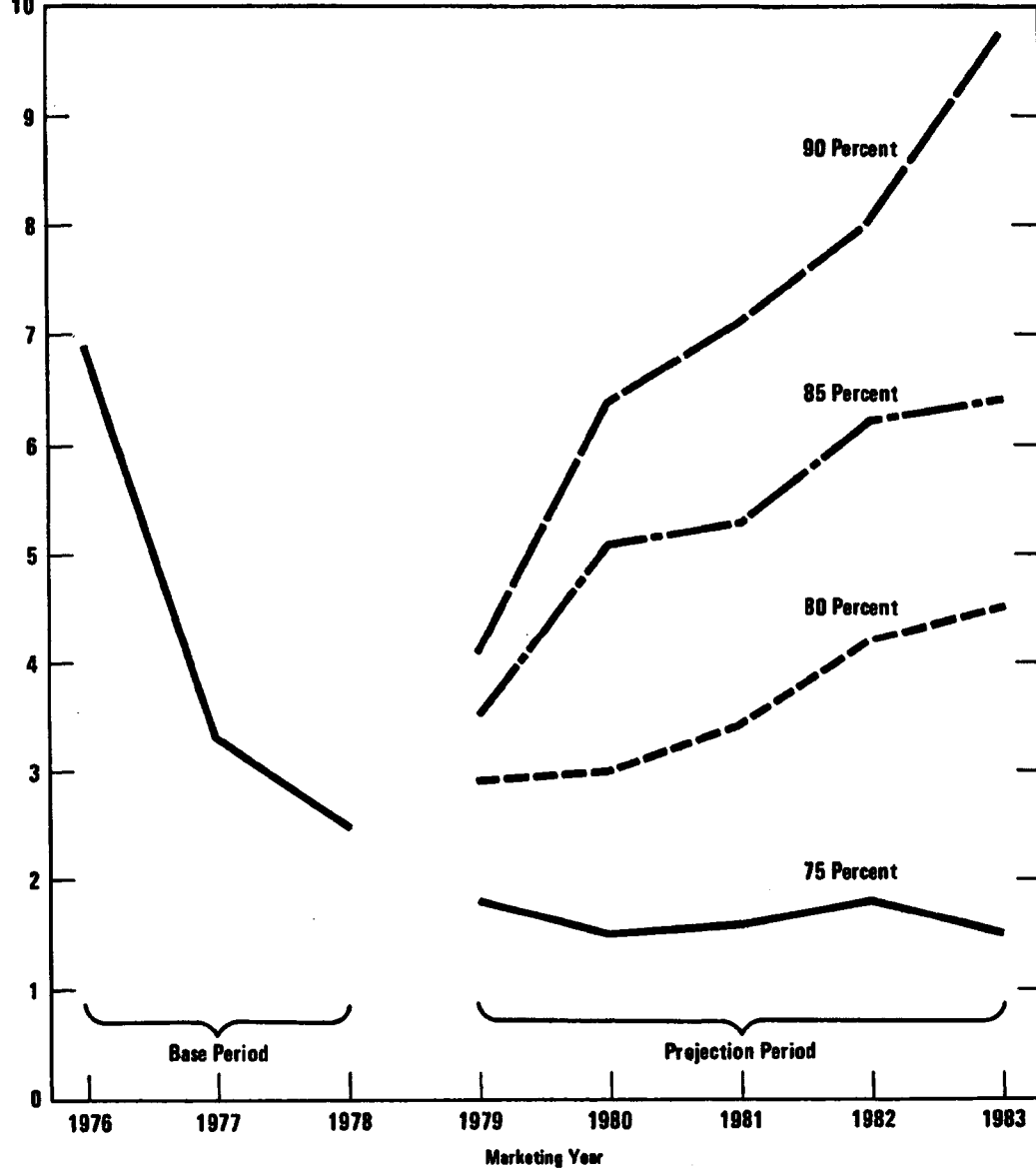
c/ Obtained by multiplying retail product prices times units sold in the domestic market.

d/ Equal to CCC purchases and related costs less receipts from the sale of CCC-owned products.

Figure 1.

Annual CCC Purchases for the Historical Base Period (1976-1977) and the Projection Period (1979-1983) Assuming 75, 80, 85, and 90 Percent of Parity

Billions of Pounds
10



85 Percent of Parity. Under a price support level of 85 percent, farm incomes and consumer prices would be slightly higher than under the current 80 percent of parity. Federal budget outlays would average approximately \$900 million a year, or \$300 million above those estimated for 80 percent of parity. Annual CCC purchases would slightly exceed what has historically been required for price stability.

80 Percent of Parity. If the minimum support price is continued at 80 percent of parity for the next five years, annual receipts from the sale of milk would average about \$18.0 billion and annual retail spending for dairy products would average \$37.3 billion. In real terms, the incomes of dairy farmers and the retail prices of dairy products would continue at current levels.

Annual CCC purchases would average 3.6 billion pounds, or about 3 percent of milk production, a level historically associated with relatively high price stability. Annual federal budget outlays would average approximately \$600 million. In short, 80 percent of parity would provide price stability and, as compared with the recent situation, would not cause any major changes in dairy farmers' incomes, consumer prices, or federal budget outlays.

75 Percent of Parity. At a minimum support price of 75 percent of parity for the next five years, annual cash receipts would average approximately \$17.1 billion and annual retail spending for dairy products would average \$36.7 billion. As compared with 80 percent of parity, cash receipts would be \$900 million a year lower. In the final year of the projection period, consumer prices would be nearly 2 percent lower and total consumption of dairy products would be 1 percent higher than under 80 percent of parity.

With the support level at 75 percent of parity, annual CCC purchases would average 1 percent of milk production and federal budget outlays would average approximately \$250 million. As compared with 80 percent of parity, there would be a greater risk of price instability, and CCC stocks would be depleted unless donations of dairy products were reduced. Increased dependence on imported dairy products might be required to achieve price stability similar to that in recent years.

In summary, our analysis shows that adequate supplies of milk would be attained with the support price at 80 percent of parity. If the support price is set at 75 percent of parity, the risks of price instability and interruptions in supply would be considerably greater. If the support price is set at 85 or 90 percent of parity, dairy farmers' incomes would be increased at the expense of consumers and taxpayers with no assurance of additional price stability.

If the Secretary of Agriculture is, once again, given discretionary authority to support the price of milk between 75 and 90 percent of parity, he may choose 80 percent of parity. Fixing the minimum level of price support at 80 percent of parity, on the otherhand, would restrict the Secretary's ability to reduce the support price in the event of an unexpected rise in milk production and excessive CCC outlays.

Mr. Chairman, I would be pleased to answer any questions.

