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## Dairy Policy Brief #4: Voluntary Supply Management

### *What is the program?*

In the mid-1980s, Congress authorized two major voluntary dairy supply management programs, both funded in part through dairy farmer assessments. Under the 1984-85 Milk Diversion Program, dairy farmers who reduced their milk marketings 5 to 30 percent from a base level were paid \$10 per hundredweight on the reduced marketings. This was followed in 1987 by the Dairy Termination Program (Whole Herd Buyout), under which the government accepted bids from dairy farmers who were willing to slaughter all female dairy cattle and remain out of the dairy business for at least 5 years. The Milk Diversion Program cut milk production sharply in 1985, but had no long-term effect. The whole herd buyout was more successful in moderating production trends, but the induced and concentrated slaughter of dairy cows negatively affected beef markets, raising the ire of cattle producers.

The objective of these government-sponsored voluntary supply management programs was to enhance and stabilize farm-level milk prices by controlling the amount of milk marketed. Recently, an industry-sponsored voluntary milk supply management program was initiated to achieve very similar objectives by using some of the same techniques. The program, labeled CWT for Cooperatives Working Together, was designed and is managed by the National Milk Producers Federation, a trade association of dairy cooperatives. Members of participating dairy cooperatives and, if they choose, independent dairy farmers fund the program through an assessment of ten cents per hundredweight on marketed milk. Currently, CWT has two methods of supply management: herd retirement and dairy export incentives. Under herd retirement, bids are accepted from dairy farmers who are willing to slaughter their current milking herd and perhaps dairy heifers. Export incentives provide participating cooperatives subsidies on exports of butter, anhydrous milkfat and cheese.

### *What are the issues?*

- **Adequate funding and participation.** Government supply management programs are funded from mandatory producer assessments and/or federal appropriations. But funding for industry-sponsored programs like CWT depends on voluntary assessments. At issue is whether participation and the associated funds raised are sufficient to enhance and stabilize farm level milk prices over the long run.
- **Free riders.** Voluntary supply management programs have a potential free rider problem—dairy farmers who don't participate in the program still receive any benefits that result from the participation of others. Moreover, to the extent that voluntary supply management is successful, some dairy farmers are likely to respond to higher and more stable prices by expanding the size of their dairy herd. This makes it difficult for a voluntary program to be successfully increase milk prices over the long run.
- **Buying air.** Voluntary supply management programs run the risk of buying air; that is, paying farmers to get out of the dairy business when they were already planning to retire. But there still may be benefits if the program requires milk cows to be slaughtered rather than sold to another dairy farmer.
- **Export market issues.** The export incentive element of CWT not only moves dairy products from the domestic market, it can also provide valuable export experience for dairy cooperatives. However, since export subsidies are not offered continually, international customers may view participating dairy cooperatives as unreliable long-run sources of dairy products. There is also a question regarding whether CWT export subsidies fall under World Trade Organization rules. While they are not government subsidies, they could trigger a WTO trade inquiry if they become large.

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## Dairy Policy Brief #5: Mandatory Supply Control

### *What is the Program?*

Quota and base programs specify the maximum amount of milk that individual dairy farmers can sell without incurring a penalty. Dairy farmers are assigned a strict marketing quota or a maximum level of marketings relative to an historical base. Economic penalties are applied to any sales in excess of the eligible marketings. The policy intent is to achieve a price goal by closely matching total milk supply with the total amount of milk demanded at the price objective.

Milk quotas have been used for many years in Canada and the European Union (EU). Quotas have never been used directly for milk in the United States, but there were programs in the 1980s that used bases to assign penalties to dairy farmers who increased production. Depressed milk prices in 2009 have renewed interest in base programs. Several proposals have been developed with a common objective of preventing low milk prices and reducing price volatility by managing the growth in milk production to more closely match the growth in commercial sales. Dairy farmers who wish to increase milk production beyond their base and in excess of the growth in milk production deemed necessary to meet commercial sales are assessed a market access fee for a period of one year. After one year the dairy farmer's base is increased to reflect the higher level of milk production.

### *What are the issues?*

- **Mandatory supply control can enhance farm milk prices without large government costs.** Quotas and base plans do not require large treasury outlays because there are no government purchases or direct payments to farmers. The quota can be set at a level that achieves relatively high milk prices to farmers as evidenced by farm milk prices in Canada compared to those in the U.S. Base plans recently proposed are less restrictive than Canada's quotas and as a result, may reduce milk price volatility but not provide as much price enhancement.
- **The value of marketing quotas/bases is capitalized and raises production costs.** When quotas and bases succeed in stabilizing or raising prices above what they would be otherwise, the difference is capitalized into the value of the quota or base (if it is transferable) or the farm to which the base or quota is attached. In Canada and the EU, the cost of quota is a major investment for farmers who want to enter the industry or expand their operations. Bases that are less restrictive on expanding production and therefore less price enhancing would create less value than quotas, but entry or expansion costs would still appear in either the purchase price of the base or the one year market access fee.
- **Quotas and bases interfere with efficient industry changes.** Depending on how it is applied, mandatory supply control can impede or prevent structural change in the dairy industry. Quotas or bases that cannot be easily transferred can lock in herd size structure within regions and prevent inter-regional shifts in milk production that would increase industry efficiency. Programs that raise milk and dairy product prices significantly above those in other countries must be accompanied by high tariffs to keep out imports. This interferes with trade liberalization objectives. Similarly, sharply elevated prices run the risk of creating consumer resistance and encouraging the use of dairy substitutes.
- **Mandatory supply control can be difficult and expensive to administer.** Dairy farmers need to be considered individually in allocating quotas/bases, and there can be difficult issues of equity in the allocation process. Individual farm production levels must be monitored to ensure compliance. Long-term milk supply and demand estimates must be made, which is a difficult and subjective process.