

Program on Dairy Markets and Policy

Information Letter

Is Reverting to the 1949 Agricultural Act Really a Possibility for Dairy Price Supports?

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With delays and controversies abounding, there are lots of stories and comments floating around about what will or won't happen to agricultural and food programs in the absence of a 2012 Farm Bill. The paper attempts to review what we know and what we don't know, especially as it relates to dairy programs.

The current status is this:

1. The Senate passed a complete "farm bill" called the Agriculture Reform, Food and Jobs Act of 2012 (S. 3240)
2. The House Committee on Agriculture approved the Federal Agriculture Reform and Risk Management Act of 2012 (H.R. 6083)
3. The House leadership has yet to allow the Committee's proposed bill to be discussed by the entire House membership and be subjected to the process of amending and voting.
4. The House did pass the Agricultural Disaster Assistance Act of 2012 (H.R. 6233), which provides some relief to a livestock industry that is reeling from direct and indirect effects of the drought.
5. The Senate leadership chose not to consider a similar livestock disaster assistance bill, arguing that the House should act on a complete Farm Bill package instead of a small, stopgap measure.
6. MILC provisions changed on 1 September, under the existing 2008 farm bill. This essentially rendered the MILC program ineffective. MILC was budgeted to continue in this ineffective state in perpetuity, until a new law

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changes it, but the 2008 bill specifies that no MILC payments can be made for milk produced after September 2012.

7. There will be no new Farm Bill, no extension of the 2008 Farm Bill, and no livestock disaster assistance before 1 October.
8. It is far from clear that there will be a new farm bill or even an extension before 1 January 2013, although it is possible to be at least hopeful of that.
9. The beginning of October, the beginning of the federal fiscal year, is significant because many provisions of the current bill expire on 30 September. In some cases, these programs simply stop. In other cases, there is old, permanent legislation that resumes control automatically.
10. Speculation is running rampant about what happens next. There has to be an extension of the 2008 Farm Bill right away. We can do an extension after the election. We should do a one-year extension and give ourselves plenty of time to do this right. We should do a 3-month extension, essentially forcing us to deal with this necessary legislation after the November election but before the winter break, i.e., in a lame duck session. How about a 6-month extension? {My advice is to ignore comments and rumors that begin with "I heard that..." I would also take with a grain of salt any comments made by any elected official. No doubt so-and-so believes what he or she is saying, but too many people whose opinions are respectable have widely different opinions.}

Where does this leave us? With a great deal of uncertainty, that is the only thing that is certain.

The scenarios supporting a new farm bill passed in a lame duck session are pretty few and unlikely. For example, if the Democrats not only retain the Senate but win the House, it is easy to imagine that Republicans would try hard to pass legislation that would achieve more of their goals for cutting spending, especially on SNAP (food stamps). Even this is hardly a sure bet, never mind that the scenario is a low probability according to most political analysts.

An extension of the existing law during a lame duck session is easier to imagine. Indeed one does not want to imagine failing to pass an extension if and when it becomes obvious that new legislation isn't going to be passed. However, there is much debate among Members of Congress about the duration of an extension.

A one-year extension is scary to legislators who want to pass a farm bill. There are two reasons for this. First, the Congress, like many college students, has a tendency to wait until the last minute. Thus, a one-year extension is interpreted as meaning it won't do anything until the end of 2013, and it will still be rushing in the final moments to figure out what to do. It is also possible that the kind of deal making that got the Senate bill done could unravel over the course of another year. Second,

the Congressional Budget Office comes out with a new baseline in March. If the new baseline projects lower costs for current legislation (presumably the 2008 Farm Bill provisions), then a 2013 Farm Bill would likely be held to achieving higher levels of savings than a 2012 Farm Bill has been, thus ensuring further and very difficult discussions about where new savings would come from. A lower March 2013 baseline could be the result of 1) programs that were terminated on 1 October 2012, 2) an improved economy that lowered projected spending on food assistance and other programs, and/or 3) higher farm prices and no reason to expect ongoing drought or other planting disasters. In my opinion, both of these are very valid concerns. Of course, for critics of farm and/or food programs, this is a desirable outcome.

What about reverting to the 1949 Act? Every time Congress gets close to a 30 September deadline, the specter of reverting to permanent agricultural law, in particular the Agricultural Act of 1949, is raised like some approaching tsunami or crack in the earth. In point of fact, this kind of brinkmanship has become more the rule than the exception of late.

The 2008 Farm Bill was supposed to be a 2007 Farm Bill. In 2007, the House passed its version of a new farm bill in July. The Senate didn't get its version done until December. The 2008 Farm, Conservation and Energy Act wasn't finalized until June 2008. As this bit of drama unfolded, USDA pondered the consequences of reverting to permanent legislation. Some of the following comes from their white paper on the subject (www.usda.gov/documents/fbpaper022908.doc). The 2002 Farm Bill wasn't passed on time either.

There are several bits of permanent legislation.

Much of the price support system for crops was made permanent in the 1938 Agricultural Act. The big crops in the 1938 Act were corn, rice, wheat and cotton; in fact, they are referred to as "basic crops". The 1938 Act also has provisions for other "non-basic crops" that are supported by a form of production quotas rather than price supports. The list of non-basic crops includes butter but not farm milk or other dairy products. It includes turpentine (a wood product) and tobacco, but doesn't include soybeans. The 1949 Act is mostly remembered in dairy circles because it created the Dairy Price Support Program, which effectively covers all milk and dairy products, not just butter. The DPSP played a role in setting a floor under the market price of milk from 1949 until 1990, when it was set so low as to be almost meaningless. The 1949 Act also added Irish potatoes and Tung nuts to the list of non-basic commodities.

The 1949 Act focuses on price supports related to parity prices, but implements them in different ways. Corn must be supported at 50-90 percent of parity, which can be achieved by loans or purchases. Wheat must be supported at 65-90 percent of parity, which can be achieved by a similar combination of loans or purchases but wheat growers are only eligible if they planted no more than their "acreage allotment". (New York had a big allotment in 1938.) Milk must be supported at 75-90 percent of

parity, and this is achieved by offering to purchase commodity butter, cheddar cheese and nonfat dry milk at wholesale prices calibrated to yield the desired farm level support price for milk used in manufacturing (this translates to Class III and IV prices in today's jargon and system.)

So, if there is no 2012 Farm Bill and no extension of the 2008 Farm Bill, does this mean wheat growers should start checking into their wheat allotment and dairy farmers should start planning how to spend \$38 per cwt milk checks? Probably not.

For crop farmers, these programs are established for crop growing seasons. The definitions of marketing years vary a bit but the bottom line is that crop farmers for the current season are covered under the programs they signed up for last Spring. They wouldn't have to worry about their wheat allotment or whatever unless we somehow manage to let all of this go slack until the next planting season.

Milk, of course, is harvested daily, but it also has a "marketing year". In the 1949 Act and for the effective life of the old program, the dairy marketing year was simply the federal fiscal year, beginning on 1 October. Beginning in 1990, the establishment of a new price support level was effectively changed to 1 January. This was more a convenience of timing for that particular legislation, not some carefully considered decision about the optimal timing of price support changes for milk. The January date has since stuck. The 2008 Food, Conservation and Energy Act specifies that the Secretary shall support the prices of cheese, butter, and nonfat dry milk from 1 January 2008 through 31 December 2012.

Thus, dairy price supports won't revert to their 1949 version until January 2013, assuming there is no action by Congress to avert that during a lame duck session. A literal interpretation of reverting to the 1949 Act would be that the Secretary would be obliged to announce a support price for milk of no less than 75% of the parity price for milk. In August the parity price was \$51.70, 75% of which equals \$38.78. The parity price could well increase by the end of 2012, but let's go with \$38 as a ballpark figure for a parity-based support price for milk. This is almost 4 times the implicit support for milk that exists under the vestigial Dairy Product Price Support Program that was created in the 2008 Farm Bill from the remnants of the prevailing Dairy Price Support Program. It is about twice the Class III and IV prices currently expected for this Fall.

So, should farmers expect that the Secretary would announce that \$38 support price at the beginning of 2013? This is a tricky bit of business for the Secretary. The law is clear. It is his duty to implement the provisions of law that pertain to the US Department of Agriculture. On the other hand, establishing a genuine support price and corresponding purchase prices for dairy commodities equivalent to \$38 or thereabouts for the next 12 months would be like some kind of bad heroin trip for the dairy sector. Farmers might revel in euphoria at first but the after-effect on markets is almost too absurd to imagine.

There are a few caveats to keep in mind. The Secretary can announce a \$38 support price for milk, but until USDA announces the purchase prices for dairy commodities and releases the formal invitations for offers at those purchase prices, nothing happens to markets, other than perhaps rampant speculation. It is USDA's purchases of butter, cheese, and nonfat dry milk at specific prices that moves market prices, not a simple declaration by the Secretary about the support price for milk. USDA could take a while to get all that machinery in motion, while Congress presumably came to its senses and retroactively stopped it all.

Another caveat involves the action that would be taken by marketers. In the past, USDA was often described as buying products as if it walked into a store and loaded up its grocery cart. In fact, USDA issues offers to purchase very specifically defined products, in specific containers, manufactured in inspected plants that conform to various government procurement rules. If no manufacturer cares to sell to the USDA, then there is no sale and no corresponding price effect. This actually happened in the 1980s and at times in the 1990s. During the 1990s, for example, brief periods of wholesale market weakness left manufacturers wondering if it was worth the bother to reformulate and repackage commodities for government sale.

With the opportunity to sell butter or nonfat dry milk to the government at twice the prevailing market price, it is hard to imagine manufacturing cooperatives not pushing all they could in Uncle Sam's direction, but even a cooperative would likely think twice before shorting existing customers for the short term high of selling to USDA in a program that no sane person could expect to continue for long. Dairy economists have no idea what this part of the dairy products demand curve looks like, but it is safe to say that Fonterra and every dairy buffalo owner in India would be tempted to export to the US well before US manufacturers tried to achieve \$4 butter in US markets.

Unless Congress has some major epiphany by Friday, it is going to fail to pass an extension of the 2008 Farm Bill by the end of the month. It may or may not get itself organized to do something during a lame duck session after the November election. I don't know exactly how this story ends, but one of the few bets I'd make is that we won't see actions taken that seriously implements the provisions of permanent agricultural support law, including a \$38 support price for milk.