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Cato Institute Briefing Paper No. 13: Our Next Criminal Class: Milk Bootleggers

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Executive Summary

Farm-state congressmen are launching another crusade to drive up dairy prices via sweeping new controls over dairy farmers and milk sales. Federal dairy policy is already costing consumers over $5 billion a year, yet the new proposals could boost milk prices another 40 cents a gallon. Congressmen have proposed federal programs to butcher hundreds of thousands of dairy cows, force consumers to drink thicker milk, and dictate how many gallons of milk each dairy farmer can sell. Instead of imposing new layers of controls, the federal government should end the dairy program and allow the free market to determine milk prices.

Introduction

Congress is on the verge of creating a new criminal class in America--milk bootleggers. Farm-state congressmen are launching another crusade to drive up dairy prices via sweeping new controls over dairy farmers and milk sales. Unfortunately, this is a classic case of politicians' reacting to the failure of existing government controls by demanding far more intrusive, restrictive controls.

In 1989 and 1990, dairy prices soared to record levels. In recent months, dairy prices have fallen back to normal levels--and congressmen are outraged. Recent congressional dairy policy proposals could boost milk prices by as much as 40 cents a gallon.

The Current Dairy Situation

The federal dairy price support sets a price floor in the marketplace, effectively guaranteeing that dairy prices will not fall below the level that Congress decrees. Retail milk prices are also inflated by Byzantine marketing regulations. The goal of federal milk-marketing order policy is to make each of 42 federal milk territories self-sufficient in milk--the Balkanization of American milk production. Milk- marketing regulations take up three volumes of the Code of Federal Regulations and require 600 federal employees to administer.[1]

Dairy farmers in recent years have done far better than most farmers. According to the U.S. Department of Agriculture, the average dairy farmer's net worth increased by 58 percent between 1987 and 1990--probably a larger jump in net worth than any other industry in the United States enjoyed.[2] The average full-time dairy farmer is worth more than half a million dollars, while over half the households in the United States have a net worth of less than $35,000.[3] In 1989 the average dairy farm family had an income exceeding $50,000.[4] The USDA reports that dairy farmers have a debt-to-asset ratio of only 18 percent--an extremely low debt load compared with that of most American businesses.[5]

Sen. James Jeffords (R-Vt.) warned last March, "As many as 6,000 to 7,000 dairy farms probably will go out of

business in the next year"[6] unless Congress sharply raises milk prices. But the number of dairy farmers has been declining for decades regardless of congressmen's best efforts. An average of over 4,500 dairy farmers have exited the industry each year since 1950. Since 1930 the number of dairy farmers has decreased 95 percent.[7] As dairymen become more efficient and productive, fewer dairy farmers can supply the nation's consumers. There is nothing inherently bad about the decrease in the number of dairy farmers, in the same way that there is nothing inherently wrong with the decrease in the number of corner grocery stores or village blacksmiths. A decline in the number of people working in any basic industry is a sign that the industry is becoming more productive and, thus, that society is becoming more affluent. The decline in the number of dairy farmers has meant that dairying has become comparatively more lucrative for the remaining farmers.

Many people are leaving dairy farming because their land has become too valuable to justify continued dairy farming. Dairyman George Franklin of Loudoun County, Virginia, told the Washington Post, "When somebody offers me $25,000 an acre, I can't afford to farm."[8] Dairy farmers who leave the profession with "severance pay" of half a million dollars or more do not make a compelling case for more federal aid to dairy farmers. Many dairy farmers are also being squeezed by the rise in prevailing wages in more developed areas. As the Post reported, "In the 1980s, dairies had to compete with suburban construction jobs that paid more than $9 an hour. Dairies could no longer pay workers a few dollars an hour to get up before dawn and work until dark."[9]

Dairy farmers are among the most protected producers in the U.S. economy. The United States has strict quotas that allow the import of the equivalent of only one teaspoon of foreign ice cream and one pound of cheese per person per year.[10] The U.S. International Trade Commission did a study that estimated the tariff equivalents of dairy import quotas. The ITC concluded that, in 1986, the quota on dry whole milk was the equivalent of a 160.6 percent tariff, the butter quota was equal to a 190.2 percent tariff, and some cheese quotas were equivalent to a 172.5 percent tariff.[11]

American farmers are among the world's most efficient and competitive producers of some products, but most American dairy farmers are not competitive by international standards. Farmers in Australia and New Zealand can produce milk at less than half the cost that the average American farmer can.[12] The USDA estimates that dairy import quotas, price supports, and marketing restrictions cost American consumers between $5 billion and $7 billion per year.[13] Since 1980 federal dairy policy has cost consumers over $50 billion, roughly $800 per American family. Taxpayers have been forced to pay $15 billion in direct subsidies for dairy farmers since 1980, or over $200 per family. For the cost of the dairy program since 1980, each American family could have bought its own dairy cow.

The Mirage of Supply Management

The federal government is currently holding 577 million pounds of surplus butter, 280 million pounds of surplus dry milk, and 38 million pounds of surplus cheese.[14] The USDA predicts that the government will buy the equivalent of almost 10 billion pounds of surplus milk this year.

The United States has had perpetual dairy surpluses because Congress insists that dairy prices do not influence dairymen's behavior. Sen. Patrick J. Leahy (D-Vt.), chairman of the Senate Agriculture Committee, declared last year, "I am absolutely convinced . . . that simply bringing down the dairy price supports is not a way to cut production."[15] Congressmen are willing to do anything to reduce dairy surpluses--except allow dairy prices to fall to a market-clearing level.

The federal government has tried several schemes to end dairy surpluses in the past. Congress launched a dairy buyout in November 1983, rewarding farmers for agreeing to reduce their dairy production. The House Republican leader, Robert H. Michel (R-Ill.), called the dairy buyout a "kill a cow for conservation" program and ridiculed government buyout payments as "loafing payments": "This is a preposterous program setting supports too high, thereby causing a surplus, and then paying people not to produce that surplus."[16] While the government paid some farmers to reduce their milk production, other dairymen were not prevented from increasing their production. At the end of the first dairy supply reduction program in early 1985, after $995 million had been spent, there were only 10,000 fewer dairy cows in the United States than there had been at the beginning.[17] The USDA paid the equivalent of $100,000 for each net cow reduction of the total American dairy herd, even though a used dairy cow is worth less than $1,000.

Congress attempted to solve the dairy surplus problem in 1986-87 by paying dairymen over $l.3 billion to slaughter

their cows. Under the Dairy Termination Program, 144 dairy owners got over a million dollars apiece to take a five-year vacation from dairying, and one California producer received $20 million. Yet, as the General Accounting Office noted, "Total milk production did not decrease because nonparticipating farmers increased their production during the program period."[18]

The Dairy Termination Program devastated many relatively unsubsidized beef cattle producers.[19] On March 29, 1986, the USDA announced that it would soon be sending 1.6 million dairy cows to slaughter--far more cows than anyone expected to be slaughtered under the dairy buyout program. That severely disrupted beef markets, costing ranchers scores of millions of dollars in losses and bankrupting some cattlemen.

At the time of the USDA's announcement, many cattlemen had already sent their herds to market and could not pull them back. They had no choice but to accept the decimated prices. Beef cattle prices in California plunged by between $100 and $120 a head--roughly 15 percent. Pat Casper, an agricultural banker with First National Bank in Billings, Montana, declared two weeks after the USDA's surprise an- nouncement that "from where I'm standing it looks like an absolute disaster. This has been the greatest injustice ever done to the cattle industry."[20] Max Thornton, a feedlot operator in Billings, noted, "What is strangling [the beef cattle] industry is disruptions in the normal production flow, like this dairy buyout. Our prices are being made in Washington, and you never know what a politician is going to do next."[21] (Despite the impact of the 1986-87 Dairy Termination Program, Senators Leahy and Jeffords are lobbying for the federal government to buy another 300,000 dairy cattle and send them to the slaughterhouse, which would once again drive down beef prices and harm cattlemen.)[22]

The U.S. government also paid lavish export subsidies on dairy cows in 1986 and 1987. Some of the export subsidies exceeded the value of the cows.[23] It would have been cheaper to push the cows off the Brooklyn Bridge. But the Senate apparently thought the earlier program a great success and recently voted to spend more tax dollars to deport dairy cows. Senator Jeffords is especially enthusiastic about the plan, though he concedes, "We do not have the mechanisms right now to be able to give the right kind of a subsidy that would be necessary to compete" with other nations' dairy cattle exports.[24] But if the United States cannot export without a subsidy, then the exports will almost certainly be a dead loss for the nation.

In March 1991 the Senate discovered a brilliant way to make surplus milk powder disappear: pass a law forcing milk processors to add surplus milk powder to fluid milk--and abracadabra!--no more surplus! That was like trying to solve the savings-and-loan crisis by requiring each bank depositor to buy a Texas office building.

Senator Leahy, the author of the dairy amendment, promised that the new standard would mean "a richer and better taste."[25] But if consumers wanted thick milk, they would buy milkshakes. There was no demand for the "improved" dairy product; milk processors were already producing a thicker milk for the tiny minority of consumers that prefers it. Leahy's amendment, which he craftily attached to the Desert Storm emergency appropriations bill, passed the Senate 60 to 40 but was later dropped by the House-Senate conference committee. [A bill to mandate thicker milk, introduced in the House on April 17 by Reps. Collin C. Peterson (D-Minn.), David R. Obey (D-Wis.), Bernard Sanders (I-Vt.), and Tim Johnson (D-S.D.), is still pending.][26]

The USDA is working overtime to dispose of its dairy stockpile. On March 1 the USDA announced a major expansion of dairy export subsidies. The U.S. government is currently paying U.S. farmers almost $l a pound for butter and selling the butter to foreigners for roughly 60 cents a pound. At a time when many Americans cannot afford to buy milk, the USDA will spend over $50 million to dump 140,000 tons of U.S. dry milk on world markets at firesale prices.

On May 10 USDA secretary Edward Madigan announced that the United States would increase the amount of dairy products donated to Third World countries.[27] Though that sounds humane, it is bad news for struggling foreign farmers. As the House Agriculture Committee report on the 1990 farm bill noted, "In El Salvador, shipments of non-fat dried milk exceeded the amount of domestic consumption causing domestic milk prices to decline and domestic production to plummet."[28] U.S. food donations have also harmed Egyptian farmers.[29]

MIMPing America's Dairy Producers

Many congressmen have decided that the only way they can successfully control the price of milk is to impose se vere controls on dairy farmers themselves. Senator Leahy re- cently declared, "A long-term solution, I think we all know, is to manage the amount of milk produced."[30] The 1990 farm bill required the USDA to perform a study on options for a milk inventory management program (MIMP) to find ways to prop up dairy prices. The USDA issued its preliminary MIMP report on May 9, 1991, and will issue the final report by June 15.[31] The House Agriculture Committee will hold hearings on the USDA's recommendation on June 18, and the Senate Agri- culture Committee on June 19. Farm-state congressmen are expected to push for legislative action as quickly as possi- ble.

There are numerous proposals for federal production con- trols on dairymen. The core of most MIMP proposals is a man- date that the USDA establish quotas for the amount of milk each dairy farmer would be allowed to sell. Most farmers' quotas would be based on their previous milk production. Thus, quotas would tend to freeze the current structure of the dairy industry, making it much more difficult for exist- ing small farmers to become medium-sized or large farmers. On the other hand, large dairy farms that received large quotas would have little to fear with the government securing their position at the top of the ladder. The imposition of quotas would sharply decrease competition among dairy farmers and thereby slow the growth of efficiency and productivity. And new or beginning farmers who sought to enter dairying after the quotas had been distributed would be at a severe disadvantage.

One proposal discussed in the USDA report is a two- tiered dairy price system--a relatively high government-guar- anteed target price for milk sold under quota and a lower price for surplus dairy products that would be dumped on world markets without regard to price. It is almost certain that, if Congress does mandate a MIMP, the result will be two different prices for the same gallon of milk, depending on whether a dairy farmer's quota covers that gallon or whether it is classified as surplus.

Naturally, that artificial distinction will spur milk smuggling. The greater the gap becomes between the high federal milk target price and the lower market price, the greater the incentive milk bootleggers will have to shuffle milk across accounting systems and between farms in order to collect a windfall. During the 1986-87 Dairy Termination Program, there were widespread reports of farmers who ille- gally "traded" their cows with other farmers so that only the oldest, least productive cows were slaughtered. If the USDA cannot even keep track of cows, then keeping track of actual milk is a pipe dream. Any two-tiered dairy price system should be labeled the Fraud Maximization Act of 1991.

To understand how the dairy quotas would operate, we should consider how similar quotas have operated in the pea- nut and tobacco programs. Tobacco is our most feudal farm program. A farmer must have a federal license (called an acreage allotment) for each hundredth of an acre of tobacco he grows. The federal government hires "tobacco police" to run around the South and measure farmers' fields to see if they are "cheating" by growing a few extra square feet of tobacco without a federal license. Anyone caught growing tobacco without a license is subject to heavy fines and pos- sible imprisonment. Most of the benefits of the tobacco program have been capitalized into the value of the tobacco allotments. A vast majority of allotments are owned by non- farmers.

The peanut program requires farmers to have a license for each pound of peanuts they grow to sell in the United States. (Production of peanuts for export is not restricted by poundage quotas.) The original quotas, which were dis- tributed in 1941, are now often owned by nonfarmers; many peanut farmers must pay tribute to doctors, lawyers, and dentists to rent the right to grow peanuts. The cost of renting quotas can add as much as 60 percent to the cost of peanut production. The USDA manipulates the annual national peanut poundage quota to create a continual artificial peanut shortage, thereby guaranteeing peanut farmers generous prof- its.

The peanut quota program has sharply decreased U.S. peanut farmers' productivity. Congress is resolved to keep the quota allotments in the same congressional districts at any cost. Quota allotments cannot be rented outside the county to which they were originally allocated in 1941. Peanuts are a soil-depleting crop that causes a decline in soil nutrients. Peanut yields in parts of Texas have long been declining. While many farmers with acres that yield below 1,000 pounds have quotas, other farmers who have more than a million acres with potential yields of 2,500 pounds or more per acre are prohibited from producing peanuts for Amer- ican citizens.

The Limits of Intervention

Congress cannot drive up the cost of milk without in- flating dairy farmers' cost of production. A recent USDA report

noted, "A recurring problem of dairy programs is that benefits are often capitalized into asset values, especially cattle."[32] Congress raised dairy price supports sharply be- tween 1977 and 1979; as a result, the cost of replacing a dairy cow more than doubled, from $504 per cow in 1977 to $1,054 per cow in 1979.[33] Artificially increased dairy prices will inevitably cost consumers far more than they benefit dairy farmers.

The higher dairy prices become, the fewer dairy prod- ucts Americans will buy. The use of butter in the United States has plummeted in recent decades largely because marga- rine provides a taste almost as good at a far lower price. Sales of "imitation cheese" (made with vegetable fat and casein) are soaring--increasing from 227 million pounds in 1982 to 449 million pounds in 1987. That was equivalent to roughly 8 percent of total cheese production in 1987.[34] The USDA estimates that a 10 percent increase in retail dairy prices would reduce Americans' purchases of cheese and butter by about 7 percent.[35] (Congress has been so successful at driving up the price of sugar that sugar consumption in the United States has nose-dived.)

Gov. Mario Cuomo of New York recently complained that the lower dairy prices have "caused personal hardships for thousands of New Yorkers."[36] Naturally, Cuomo was thinking only of the impact of dairy prices on dairy farmers. Dairy products account for 13 percent of the average consumer's food budget.[37] Sen. Richard G. Lugar (R-Ind.) notes, "Fami- lies with incomes below $10,000 spend three times as much of their disposable income on milk as do households with incomes between $30,000 and $40,000."[38] Thanks in part to the dairy program, calcium has long been the nutrient that poor people lack most; higher milk prices have also contributed to osteo- porosis in the elderly. But, since poor people do not donate $2 million a year in campaign contributions, as does the dairy lobby, congressmen can ignore malnourished ghetto chil- dren and brittle-boned senior citizens.

Conclusion

The congressional Office of Technology Assessment esti- mates that milk output per cow could double and that 5,000 large dairy farms could supply the nation's milk needs by the year 2000.[39] The cost of dairy production fell 4 percent in 1987 alone, and milk output per cow jumped 3 percent in 1988. Computerized feeding methods can boost milk yields another 5 percent without increasing a herd's total feed requirement. Artificial insemination, embryo transfers, and cloning are helping to boost average dairy cow productivity by a steady 2 to 4 percent a year.

The real time bomb ticking away beneath the federal dairy program is bovine growth hormones (BGH). BGH can boost milk production by up to 30 percent per cow at little addi- tional cost. BGH naturally reproduce the hormones within cows that stimulate milk production and, thus, are far more natural than are the controversial beef hormones. The Food and Drug Administration has concluded that there is no sig- nificant difference in milk from regular cows and cows treated with BGH and is expected to approve the hormones early next year. Several states have already imposed morato- riums on the use of BGH. By sharply increasing dairy produc- tivity, BGH could destroy federal regulators' ability to tightly control national milk markets. Naturally, that ter- rifies the farm groups that have profited greatly thanks to federal intervention.

Eggs share many of the market characteristics of dairy products, including perishability, yet there is no federal program for eggs, and there have been no reports of egg shortages in the last 10 years. Egg prices fluctuate sharp- ly, and consumer spending is adjusted accordingly. Over the past 30 years, the real price of eggs has fallen roughly 50 percent, while the real price of milk has changed little de- spite a sharp fall in its average cost of production.[40]

While dairymen claim they need almost unlimited federal aid, cattlemen receive almost no handouts. If the free mar- ket works for beef production, why should milk producers be treated differently?

When Congress passes a new dairy program bill and sends it to the White House, it will provide an acid test for the Bush administration and Secretary of Agriculture Edward Madigan. If the administration caves in--as it recently did to the congressional peanut lobby in its refusal to allow an increase in peanut imports[41]--then American consumers can count on more years of artificially inflated prices and rela- tive shortages of the healthiest food. If Bush does veto any new dairy program, it is extremely doubtful that the dairy lobby will be able to override his veto in the House of Rep- resentatives.

Should a person be required to have a federal license to sell a gallon of milk to his neighbor? It is a symbol of the

decline of liberty in America that Congress is even consider- ing such a question. If somebody proposed to require consum- ers to acquire a federal license for each gallon of milk they bought, the proposal would be denounced as the height of idiotic tyranny. But there is no difference in principle between imposing such controls on consumers and imposing them on producers.

With its dairy import quotas, the U.S. government has already prohibited American consumers from buying dairy prod- ucts from the vast majority of farmers in the world. Now Congress is on the verge of imposing severe restrictions on the amount of milk that American consumers will be allowed to buy from U.S. dairy farmers. Where will it end? The promise of higher prices is the political siren of Lorelei that is drawing dairy farmers to their doom.

Congress has long since demonstrated its total incompe- tence at managing the dairy industry. The nation's prisons are already crowded enough without Congress's creating a new class of criminals in the dairy business. It should not be a federal crime to sell nutritious food at low prices. Rather than create a new bureaucratic monstrosity, Congress should abolish the existing dairy price supports and milk-marketing regulations at once.

Notes

[1] For an excellent summary of the current milk-marketing or ders, see Scott Kilman, "Why the Price of Milk Depends on Dis tance from Eau Claire, Wis.," Wall Street Journal, May 20, 1991.

[2] U.S. Department of Agriculture, "Dairy Situation and Out look Report," January 1991, p. 23.

[3] Ibid., p. 26. The USDA report gives $456,856 as the aver age net worth of all dairy farmers. Since that number includes a large number of part-time dairy farmers, the actual figure for the full-time farmers is significantly higher.

[4] Ibid., p. 26.

[5] Ibid., p. 26.

[6] Congressional Record, March 19, 1991, p. S 3501.

[7] General Accounting Office, "Federal Dairy Programs--In sights into Their Past Provide Perspectives on Their Future," February 1990, p. 13.

[8] Robert O'Harrow, Jr., "Cowbell Tolls for Dairies in Loudoun," Washington Post, April 29, 1991.

[9] Ibid.

[10] U.S. Department of Agriculture, "Handbook on Section 22 Dairy Quotas and Import Licensing System," April 1988. The information on the equivalent amount of ice cream and cheese was calculated by dividing the total amount of the quota by the U.S. population.

[11] U.S. International Trade Commission, Estimated Tariff Equi valents of U.S. Quotas on Agricultural Imports and Analysis of Competitive Conditions in U.S. and Foreign Markets for Sugar, Meat, Peanuts, Cotton, and Dairy Products (Washington: ITC, 1990), p. xvi.

[12] Ibid., pp. 642.

[13] U.S. Department of Agriculture, Estimates of Producer and Consumer Subsidy Equivalents, Government Intervention in Agri culture, 1982-87 (Washington: USDA, 1990), p. 310. The consum er costs per year ranged from a low of $5.1 billion in 1983 to a high of $7.025 billion in 1984.

[14] Interview with Robert Feist, U.S. Department of Agricul ture, June 3, 1991. Leading dairy policymakers are surprising ly ignorant of the current federal dairy stockpile. Sen. James Jeffords of Vermont declared on the floor of the Senate in March, "I do not believe there is much butter in storage right now." Congressional Record, March 19, 1991, p. S 3512. At the time, the Agriculture Department had over 400 million pounds of surplus butter.

[15] James Bovard, "The Sacred Cows That Keep Milk Prices High," Wall Street Journal, May 9, 1989.

[16] Congressional Record, October 18, 1983, p. H 8286.

[17] Washington Post, June 18, 1985.

[18] General Accounting Office, "Dairy Termination Program: A Perspective on Its Participants and Milk Production," May 1988, p. 2.

[19] For more details, see James Bovard, The Farm Fiasco (San Francisco: ICS Press, 1989), pp. 110-13.

[20] New York Times, April 10, 1986.

[21] Ibid.

[22] Guy Gugliotta, "Law of Supply, Demand Raises Beef in Sen ate," Washington Post, May 21, 1991.

[23] General Accounting Office, "F.A.S. Management of the Live stock Cooperator Program," October 1987, p. 6.

[24] Congressional Record, March 19, 1991, p. S 3502.

[25] Congressional Record, March 19, 1991, p. S 3499.

[26] Congressional Record, April 17, 1991, p. H 2373.

[27] "Madigan Announces Dairy Relief Measures," USDA Press Re lease no. 0485-91, May 10, 1991.

[28] U.S. Congress, House Committee on Agriculture, Report on Food and Agricultural Resources Act of 1990, H.R. 3950 (Wash ington: Government Printing Office, 1990), p. 370.

[29] Ibid.

[30] Congressional Record, March 19, 1991, p. S 3499.

[31] U.S. Department of Agriculture, "Report on Milk Inventory Management Programs," May 9, 1991.

[32] U.S. Department of Agriculture, "Dairy Background for 1990 Farm Legislation," March 1990, p. 8.

[33] Ibid., p. 8.

[34] Ibid., p. 13.

[35] Ibid., p. 37.

[36] Congressional Record, March 19, 1991, p. S 3510. (A letter from Cuomo to Sen. Al D'Amato was introduced into the record.)

[37] Ibid., p. 38.

[38] Congressional Record, March 19, 1991, p. S 3505.

[39] Bovard, "The Sacred Cows."

[40] Bruce Gardner, The Governing of Agriculture (Lawrence: University of Kansas Press, 1981), p. 134.

[41] For details on the controversy over peanut import quotas, see James Bovard, "Trade Nuttiness," Wall Street

Journal, De cember 16, 1990.