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Milk Madness

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The federal government has subsidized and regulated the dairy industry since the 1930s. A system of “marketing order” regulations was enacted in 1937. A dairy price support program was added in 1949. An income support program for dairy farmers was added in 2002.

As part of this year’s farm bill, Congress may reauthorize dairy programs, but they are among the most illogical of all farm programs.¹ The government spends billions of dollars reducing food costs through programs such as food stamps, yet dairy programs increase milk prices. Dairy programs create milk cartels, yet federal law generally prohibits cartels. Current dairy policies don’t make any sense, and they are ripe for repeal in 2007.

Structure of Federal Dairy Programs

Marketing Orders. The Federal Milk Marketing Order system sets minimum prices for milk products. About two-thirds of milk is produced under federal marketing orders in 10 regions of the country. Most of the rest is produced under California’s separate system of regulations.

The federal system is structured around four classes of milk product: fluid milk, ice cream and yogurt, cheese, and butter and dry milk. Each month the U.S. Department of Agriculture sets separate prices for fluid milk in the 10 regions, and nationwide prices for the other three types of dairy product, using various formulae. Processors must pay for milk on the basis of how it will be used, but all farmers in a region receive the same blended price.

Marketing orders essentially create cartels that limit competition. Entrepreneurs are not allowed to supply milk at less than the government prices. The system also limits the ability of milk producers from lower-cost regions, such as the Midwest, from gaining market share in higher-cost regions, such as the Southeast.

Price Support Program. The Milk Price Support Program keeps market prices artificially high by guaranteeing that the government will purchase any amount of cheese, butter, and nonfat dry milk from processors at a set minimum price. Those guaranteed

purchases of storable products create steady demand and higher prices for the products of all dairy farmers. Note that the price support program props up dairy prices at the same time that the income support program encourages overproduction, which puts downward pressure on prices.

Income Support Program. The Milk Income Loss Contract program, which was enacted in 2002, provides cash subsidies to milk producers when market prices fall below target levels. The 1996 farm law was supposed to reduce dairy subsidies, but instead dairy subsidies increased as a result of a series of supplemental spending bills in the late 1990s. Those supplemental “market loss” subsidies ultimately morphed into the more permanent MILC program in 2002.

Import Barriers. U.S. imports of milk, butter, cheese, and other dairy products are limited by “tariff rate quotas,” which are tariffs that vary by import volume. Import barriers are a complement to dairy price supports because they help keep domestic prices artificially high. Without import barriers, U.S. consumers could simply purchase lower-priced foreign dairy products. Imports of cheese, butter, and dried milk are limited to about five percent or less of U.S. consumption.²

Export Subsidies. The Dairy Export Incentive Program was introduced in 1985 to provide cash subsidies to U.S. dairy producers who sell in foreign markets. Because U.S. dairy policies keep domestic prices above world prices, producers would otherwise have little interest in selling abroad. Thus, dairy export subsidies create an incentive to export and help remove surpluses caused by overproduction from the domestic market.

Effects of Federal Dairy Programs

The USDA says that the purpose of milk marketing orders is to “promote orderly milk marketing relationships to ensure adequate supplies of milk and dairy products to meet consumers’ demands at reasonable prices.”³ But it is unlikely that dairy products need subsidies and controls to fulfill those goals. After all, the market price system

achieves “adequate supplies” at “reasonable prices” without government help for thousands of other products such as automobiles, books, and computers.

In fact, current dairy policies do not deliver “reasonable” prices at all. Because of federal controls, milk prices are higher than they would otherwise be, which penalizes millions of families. The Organization for Economic Cooperation and Development found that U.S. dairy policies create a 26 percent “implicit tax” on milk consumers.⁴ This milk “tax” is regressive, causing relatively greater harm to low-income families.

The Government Accountability Office compared U.S. dairy prices to world prices over a seven-year period.⁵ It found that U.S. prices for butter averaged twice the world price, cheese prices were about 50 percent higher, and nonfat dry milk prices were about 30 percent higher.

The taxpayer costs of dairy policies are also of concern. Those costs range from zero to \$2.5 billion annually depending on market conditions.⁶ Dairy policies are expected to cost taxpayers at least \$600 million over the next decade.⁷

U.S. dairy policies also harm international trade relations. Dairy subsidies are a barrier to moving ahead with the stalled Doha Round of trade talks. U.S. trade protections for agriculture have inhibited the liberalization of trade in other sectors, to the detriment of U.S. companies that want to expand their exports and consumers who would benefit from lower prices.

Entrepreneurs Not Allowed

The irrationality of federal dairy controls was driven home by the struggle over dairy entrepreneur Hein Hettinga in 2006.⁸ Hettinga, a Dutch immigrant, began a dairy farm and milk bottling plant in Arizona in the 1990s outside of the government system. He sold his milk to local Arizona stores and to Costco in California at 20 cents per gallon less than government-regulated milk. His low prices met with a strong demand, and his business expanded rapidly. Costco executives believed that consumers were being “gouged” by the government system, and they were happy to provide customers with Hettinga’s discount milk.

However, farmers and others in the regulated system were not happy with the competition from Hettinga. They pushed for Congress to intervene, and a political battle ensued, which cost more than \$5 million in lobbying fees. Both Democrats and Republicans sought to protect home-state dairy interests, and they teamed up to crush Hettinga and close the channel through which he was operating.⁹

Based on his experience, Hettinga said “I had an awakening . . . it’s not totally free enterprise in the United States.”¹⁰ That lack of free enterprise not only keeps milk prices high, but results in a U.S. dairy industry that is not as innovative as the less regulated New Zealand industry.¹¹ The dependence on government purchases of dry milk, for example, has “removed the incentive for companies to diversify and invest in the production of high-value dairy products of the future.”¹²

Conclusions

U.S. dairy programs are Byzantine in their complexity and create the most rigidly controlled of all agricultural markets. The ultimate effects are to transfer income from consumers and taxpayers to dairy businesses and to stifle innovation in this \$90 billion industry.

In this year’s farm bill, the Democrats have a chance to repeal the special interest giveaways of prior Republican farm bills, including the regressive “milk tax.”

¹ For background on this year’s farm legislation, see www.cato.org/downsizing/agriculture. Also see Sallie James, “Milking the Customers: The High Cost of U.S. Dairy Policies,” Cato Institute, November 9, 2006.

² Daniel Sumner and Joseph Balagtas, “United States’ Agricultural Systems: An Overview of U.S. Dairy Policy,” 2002, p. 8, <http://aic.ucdavis.edu/oa/working.html>.

³ James Miller and Don Blayney, “Dairy Background,” United States Department of Agriculture, July 2006, www.ers.usda.gov/publications/ldp/2006/07jul/ldpm14501.

⁴ Organization for Economic Cooperation and Development, “Agricultural Policies in OECD Countries: Monitoring and Evaluation,” 2005, p. 294.

⁵ Government Accountability Office, “Dairy Industry: Information on Milk Prices, Factors Affecting Prices, and Dairy Policy Options,” GAO-05-50, December 29, 2004, p. 106.

⁶ Ralph Chite, “Dairy Policy Issues,” Congressional Research Service, June 16, 2006, p. 7.

⁷ U.S. Department of Agriculture, “Administration’s Farm Bill Proposal,” undated, www.usda.gov/documents/07sumbudgetscore.pdf.

⁸ Dan Morgan, Sarah Cohen, and Gilbert Gaul, “Dairy Industry Crushed Innovator Who Bested Price-Control System,” *Washington Post*, December 10, 2006, p. A1.

⁹ Public Law 109-215 was enacted in April 2006. For further information see Chite and www.keepmilkpriceslow.org.

¹⁰ Morgan, Cohen, and Gaul.

¹¹ Joseph Balagtas, “U.S. Dairy Policy: Analysis and Options,” American Enterprise Institute, May 17, 2007, p. 9, www.aei.org/research/farmbill.

¹² International Dairy Foods Association, “Ensuring a Healthy U.S. Dairy Industry,” 2007, www.healthydairyindustry.org.