A few weeks ago, I wrote an article for the MPC Friday Report that told a bit of the history of how the California quota system came into being back in the 1960s. I linked that article to some very informative histories that have been put together which give perspective and context to why producers at that time did what they did. I mentioned in that article that maybe someday I would tell my version of how the fixed $1.70 quota differential came into being in the early 1990’s. Well, here goes.

I will start this story with the passage of 1977 Farm Bill. That bill raised the Federal Support Price for milk from $8.26 per cwt. in 1977 to $13.49 in 1981. You can imagine what a $5 per cwt. increase in the milk price did to production in the United States, and especially in California. It skyrocketed. The only limiting factor for California producers was the fact that we did not have enough plant capacity to handle all that new milk, so the state responded by raising the make allowance as an incentive to build more processing plants. California milk production doubled in the decade that followed, passing Wisconsin as the nation’s #1 milk producing state in the early 1990s.

With that information as a back drop, let’s look at the quota story. When the system started in 1969, all the producers then in business received California “production base” for all their milk production during the base period of 1965/66. They were then issued pool quota based on what percentage of their “production base” was used as class 1 (fluid milk) during the base period. Right away, some producers got more quota than others because they were selling to plants that had a higher class 1 utilization then other plants. BUT the commitment was there to eventually cover everyone’s “production base” with quota as new class 1 sales took place in subsequent years. Class 1 sales growth was slow.

Consequently in 1976/1977, “blue sky” quota was issued to all of the original 1969 producers so that everybody was “equalized.” By 1977, the original intent of the pooling program was met. We had a statewide pooling system that allowed all producers to share in class 1 proceeds regardless of where they shipped their milk because everyone had quota. The original crafters of the pooling system never imagined that California dairy farmers would be willing to produce milk for “overbase” prices. Enter the 1977 Farm Bill.

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USDA to purchasing butter, powder and cheese at prices which would enable dairy product manufacturers to pay at least the support price for milk, it was a whole new ball game in the California dairy industry. Suddenly producing overbase milk was profitable and having quota was not that big of a deal. The higher make allowance in California brought about the California cheese industry with big increases in butter and powder production not far behind. The days of California being just a fluid state were over and we became a major player in the manufactured dairy product market.

In the early years, the biggest buyer of this increased California production was the federal government and eventually something had to happen – so it did. Starting in 1981, the federal government began to ratchet back the support price and implemented a variety of programs to cut milk production. You might remember the milk diversion program of 1983 or the whole herd termination program of 1985. So, the economics were getting tougher on producers in California as huge amounts of milk were now being produced. This milk was not covered with quota and the state’s ability to help producers by raising class 1 prices was limited because all class 1 money went only to the quota holders. Eventually the concerns of overbase producers got to a point where the legislature got involved and asked the California Secretary of Agriculture to set-up a Dairy Industry Review Committee to come up with some answers.

That committee was established in 1991 and started its work by holding seven meetings around the state to take input from producers on two specific questions: “What problems, if any, are there in the pooling and quota system?” and “What long-term improvement, if any, can be made in the pooling and quota system to strengthen the program for all producers?” You can read the 1991 meeting notice and committee roster here.

These meetings were set up with the Dairy Industry Review Committee sitting at a table in the front of the room and anybody could come up and speak. The committee members would ask questions and engage with the speakers and each other, with a court reporter transcribing the meetings. After the series of meetings was concluded, the Dairy Industry Review Committee began regularly meeting in Modesto and working its way through the issues and developing and debating various options for change. It took a while, but it was a serious group of producers with varied perspectives and experiences that in good faith wrestled with how to proceed. The reality we struggled with was that milk income was too low and the state believed that it was very limited in raising milk prices for butter/powder and cheese because it felt we needed to keep our manufacturing plants operating. Therefore, class 1 was the only price that could be raised without hurting sales, but increased class 1 money would only go to the quota holder and there were now a lot of producers who did not have much or any quota.
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Eventually the solution emerged. We would fix the differential between quota and overbase at its historic average of $1.70 and then the state would significantly raise the class 1 price. Because the differential was fixed, the extra class 1 revenue would then flow over to the overbase price. That was essentially the deal. The overbase producer received access to class 1 money in exchange for giving the quota holder a fixed return on the quota. It took a while to get all this put in place, but on January 1, 1994 the fixed differential took effect and the class 1 price was simultaneously raised by nearly $2 per cwt. As a member of the Dairy Industry Review Committee, I was proud of this compromise which was done to help all producers, but especially the overbase producers who for the first time had access to class 1 revenue.

But of course, that is not the end of the story. Now that California class 1 prices had been raised to very high levels, opportunity to exploit the inherent weakness of a state milk marketing order came into play. Because a state may not regulate interstate commerce, those high class 1 prices became a magnet for out of state milk coming into California and skimming off those class 1 dollars. Very soon after the implementation of the fixed $1.70, out of state milk began coming in. The industry tried a variety of regulatory methods to try to stem the tide, but at the same time the state began to lower class 1 prices to try to limit the huge financial incentive for out of state milk to come in here.

Obviously, lowering class 1 prices diminished the benefit to overbase producers that they thought they were getting with the fixed differential, but overall the fixed differential was still a positive. And of course, to have any benefit from class 1 sales in California we had to stem the tide of out of state milk. In the end, none of the state’s regulatory fixes proved successful and the only thing that kept the flow of out of state milk from growing is that the class 1 prices were moderated to a point where the hauling cost to bring out of state milk into California became the limiting factor.

Meanwhile the California industry continued to grow. We had our ups and downs. Collectively producers came to a point where the high make allowance policies of CDFA were opposed. The policy received a nickname called the “California discount” and pressure for change mounted. In the subsequent years, California’s cost of production competitive advantage on the rest of the country had diminished and running a state order that could not regulate interstate commerce and insisted on establishing discounted prices for manufacturing milk became a problem that required a change.
The cooperatives took the lead in proposing a Federal Milk Marketing Order for California that would address these fundamental problems with the state order. It took years, but that has happened and most California producers should have more money in their pocket today because of the FMMO than they would have had otherwise. However, there is this lingering question about quota and how does it fit into where we are today. It appears that question is the next challenge facing California producers.

We have faced tough issues before and dealt with them. This issue should be no different. We stand on the shoulders of those who went before. Each generation in its time did its best to address the problems of its day. I am confident that this generation will do the same.