One Producers Perspective on the Analysis of Proposed Programs to Mitigate Price Volatility in the US Dairy Industry

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On Wednesday September 29, 2010, I sat in and asked questions on a meeting at World Dairy Expo that shared the analysis of the above mentioned programs from Mark Stevenson of the University of Wisconsin and Charles Nicholson from Cal Poly. Also participating was Scott Brown from University of Missouri.

- The three programs evaluated were the House Bill, Costa (H.R. 5288) and Senate Bill, Sanders (S. 3531) listed as C/S (Costa/Sanders bills).
- The Marginal Milk Pricing (MMP) program proposed by Agri-Mark Cooperative.
- And the current elements proposed of the Foundation for the Future (FFTF) proposed by National Milk Producers Federation (NMPF).

You can view the full report of their analysis of these three programs at http://dairy.wisc.edu. I recommend that at a minimum, you should read the first two pages which relate the Executive Summary and the Key Results. Better yet, read the entire analysis and develop your own opinions on what they tell you.

Nicholson & Stevenson supposedly had no bias in the development of this report; however, Brown had worked with NMPF in developing the FFTF program which actually has several components which have not yet been released by NMPF. They admit that they have not yet developed a Federal Milk Marketing Order (FMMO) reform program and do not yet know what levels of margin insurance they feel the government should provide compared to the level of supplemental insurance a producer should purchase for himself.

They made some good points concerning what the pricing problem is for dairy producers whether it was P**rice Adequacy or Price Volatility**. They shared that the only way to solve the problem of price adequacy is through direct government payments, or an active price support program when prices are low. One additional way would be to control supply to the level that it raises milk prices but that would also require a system to keep exports out of the US, or those imports would impact the supply.

Along with the analysis most in attendance agreed that price volatility was more the problem than price adequacy relating that producers reinvested the profits when milk prices were high and then were short when prices suddenly dropped. They showed a history of several distinct price peaks and valleys which have become much more dramatic since 1988. They called these market shocks.

Following is a graph sharing the Key Plan differences. The following are explanations of terminology of some of the abbreviations used in that graph:

- DPPSP (Dairy Producer Price Support Program)which is the current price support system.
- FMMO refers to the Federal Milk Marketing Orders or regions across the US
- MAF refers to a producer who makes a planned growth and would pay a Market Access Fee for their additional production over an established base.

The major key plan similarities & differences include:

	FFTF	**MMP**	**C/S**
Safety Net	Replaces MILC & DPPSP with margin Insurance.	Keeps MILC & DPPSP.	Keeps MILC & DPPSP.
Price Discovery	They plan to reform the FMMO but have not shared their plan.	No change to FMMO.	No change to FMMO.
Supply Management	No payment on % of milk when margin trigger is met.	Reduced payment on % of milk considered surplus.	Allowable growth % with MAF for excess growth.
Use of funds	Purchase excess products & give away.	Purchase excess products & give away.	Redistribute proceeds to producers who do not expand.

One of the important analyses of the study shared that with the FFTF the government expenditures would be reduced to producers while both MMP & C/S programs would continue government support programs at present levels. However they also share that under the current administration there was little support to continue supporting Agricultural programs at current levels and perhaps there would be no support at all.

On page 32 of the full report under:
Government Expenditures. With shocks:
Cumulative government expenditures are somewhat higher than for the scenarios without shocks for the Baseline. With no shocks the baseline showed Government expenditures over the 7 years of 2012 through all of 2018 to be just $500 million dollars. With the normal market shocks, the relative magnitude of government expenditures is altered compared to the situation without shocks. The CS program is the least costly (has expenditures similar to the scenario without the shocks), whereas the MMP and FFTF are projected to cost about $1.5 billion over

the simulated time horizon. The rapid increase in government expenditures under FFTF is due to DPMPP (Dairy Producer Margin Protection Plan) payments resulting from low prices coupled with higher feed costs in 2017 (Figure 25).

Here is where my own personal analysis begins:

I did some quick calculations and $500 million dollars divided by our current 9.2 million cows and then divided by the seven years of the program would amount to $7.77 per cow per year of government support. Even at the $1.5 billion government expenditure it would only amount to $23.30 per cow per year. Calculate that for your herd are see if you feel that will take the volatility out of the low price times. Perhaps we would do ourselves well to just eliminate government involvement altogether in the dairy support system and go with a free market. I'll share more on my view of free markets later.

The second major component of all three plans is the Supply Management Plan. The fallacy in all the plans is that they don't address the issue of imported products coming into the US and taking away domestic sales which relates to the Adequacy question earlier in the analysis. Nor do they address the potential to market more powder products into the world market to reduce imports and replace them with domestic production

I'll admit that I don't fully understand WTO agreements but in essence what I do understand is that we can't subsidize any dairy sales or marketing without impacting our WTO agreements.

I don't have a plan but I will share a scenario I feel would meet these demands:

I have strong concerns on how the US dairy industry evolves under any type of a supply management system that doesn't do something to reduce imports by encouraging more exports through a pricing system that allows us to compete and causes US processors to produce products in higher demand on the world market than what we majorly produce in the US.

My friends in New Zealand produce about 15% of their milk for the domestic market while they sell the other 85% on the world market and pretty much receive the highest world market prices. The 15% that is utilized domestically garners a higher price for the producer than does the milk sold on the world market. Since it's a small part of production it doesn't impact producer blend price very much.

Our history herein is almost the reverse. We utilize about 85% of our current production in Class I, II & III as well as some Class IV. The difference is that the US government currently purchases our excess production of Class III & IV products and stores them on the premise of reselling them when supplies diminish below market needs. That might have been common twenty or more years ago but under today's production scheme there are rarely shortages for the market. We also are not consistently in the world market because our storage price and product makeup don't consistently meet world prices or demands. In fact we likely help set world prices at just under what the US government is willing to purchase and store products for.

In my scenario we would have a producer milk price for Class I, II & III that is established based on the domestic utilization of those products and a producer price for Class IV production that

matches world market prices. That should allow us to legally under-cut the prices paid for imported Class IV products because we wouldn't have delivery costs that compared to imported products. We would need a system of daily reporting of commodities produced to prevent US processors from purchasing surplus milk and developing it into higher value domestic products. In today's electronic age that should be doable. Our US pricing structure would be totally the opposite of the New Zealand system. We would have 85% of our price based on domestic utilization and only 15% of our price based on world prices. With that type of a system we should have a blend price that is much higher than the New Zealand blend price. With no government support we could demonstrate that we are a free market in WTO standards.

Every milk pricing guru I have discussed this with says it can't be achieved, but no one has told me they have even tried to assemble this type of a system. They all say it is too risky. I believe they mean too risky for processors and cooperatives. It can't be any riskier that what producers have dealt with since late 2008.

That's my view of a solution to diminish the volatility in the dairy markets in the US. In this system if blend prices drop below a reasonable margin, with no government support we would likely reduce production and the first thing we do is reduce the volume of the lower value Class IV milk which would increase our blend price for our production and not reduce domestic supply. I'd sure like to see a program of this type proposed.