

A PATH TOO FAMILIAR

SOLVE REAL PROBLEMS, DON'T PATCH OLD ONES

The author, an Indiana dairy farmer and member of the Dairy Policy Action Coalition, shares his thoughts on federal dairy policy.

By Dave Forgey

I fear we are headed down the same old paths when it comes to reforming dairy policy. Proposals, such as the National Milk Producers Federation's "Foundation for the Future," do not adequately recognize the changes in an industry still largely operating under rules written in the 1930s and 1940s.



FYI

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Back when many provisions of current dairy policy were first written, there weren't many exports. The legislation was set up to subsidize producers, through government price supports, to serve the domestic fluid milk market. It still basically does.

This program is outdated because distribution infrastructure and product standards have changed over the decades.

Since the U.S. government is still subsidizing milk producers in the rest of the world – who have milk or dairy products to export – typically set their margins just below the U.S. price. The net result is countries seeking to import dairy products, primarily China, can buy product specific to their needs, on a more consistent basis, for a lower price than from the United States.

And, with the dairy product price support program in place, processors haven't had an incentive to innovate and make products sought by international buyers, even though those buyers are becoming a bigger part of the marketplace.

Even with these barriers in place, the U.S. Dairy Export Council (USDEC) says we're exporting 14% of our domestic production – with our less desirable products – because the world can't get anything else.

To their credit, NMPF's Foundation for the Future (FFTF) program addresses one of the two major issues, calling for the elimination of the price support and product storage program.

The problem is, FFTF then skirts other issues with patches that are only temporary fixes. It's time to implement changes to bring milk pricing and product development and distribution into the 21st century.

Two challenges

- FFTF fails to address two major challenges:
1. Why is there manipulation in the Chicago Mercantile Exchange (CME) markets?
 2. Why is the U.S. not the innovator in producing dairy products the world demands?

The answer to the first question is there are so few traders on the CME, and so few products actually sold, that manipulation is rampant. USDA National Ag Statistics Service reporting is only weekly, and auditing is almost non-existent.

Recent dairy product and milk price swings illustrate some of the problems. Earlier this year, there was extreme pressure on the CME to bring milk prices down, and futures prices indicated levels of stored products were still excessive. That manipulation worked to bring expected producer prices for January and February 2011 milk well below prices seen in the fall of 2010.

However, in the first weeks of February, the markets exploded when the "powers that be" could no longer hold the prices down.

The Dairy Policy Action Coalition would like to see more CME price transparency, with more products reported in the NASS survey – more than just cheddar cheese, butter, nonfat dry milk powder and whey – and quarterly auditing. In a recent meeting, House Ag Committee staffer John Goldberg said the reason increased auditing was not implemented – as already approved under Section 1510 of the 2007 Farm Bill – was the \$3 million cost.

DPAC member and North Carolina dairy farmer Ben Shelton suggested producers would gladly pay that cost. I calculated the cost for the 189 billion lbs. marketed in the United States annually would cost \$0.0016/cwt.

The answer to the second question is that processors currently have a guaranteed "make allowance," with no incentive to develop new products. Our less desirable products only fit the market when the world has a higher demand than Oceania can supply.

Also, a large percentage of U.S. imports come here because they are innovative, allowing our food manufactures to develop unique foods. They are products U.S. food manufacturers can't access domestically, because our dairy processors don't make them.

It is unique, then, that NMPF supports a supply management program, but not product innovation for balancing production with world trade.

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On the other side of the coin, the International Dairy Foods Association resists supply management because that would take away market imbalances being used to suppress prices on the CME – very notable early in 2011 – that would give them a price advantage.

Neither organization discusses how we will develop and produce products demanded in the world. Without that development, we must look to the government for margin insurance and supply controls.

A margin insurance tool already exists with the Livestock Gross Margin (LGM)-Dairy program. Rather than add the national margin insurance proposed under FFTF, the LGM tool could be improved to allow more access. LGM allows producers to choose their options. NMPF's margin insurance also doesn't give the regional options offered by LGM-Dairy.

The role of imports

It is well accepted the U.S. domestic market currently utilizes about 85% of our domestic

Please turn to page 12

milk production. The problem lies with the other 15%. It is a very cloudy picture what happens to that percentage, as well as how much dairy products are imported. My question is: Are they equal, or could we actually be a deficit production country already?

Order reform: Questions remain

DPAC invested in dairy policy analysis done by Mark Stephenson, director of dairy policy analysis at UW-Madison; and Chuck Nicholson, from the department of agribusiness at California Polytechnic Institute, San Luis Obispo, Calif. DPAC would like to see more comparisons and the inclusion of the federal order reform NMPF promises. But until we see what reforms NMPF has proposed, we can't have a lengthy discussion. There are things I believe should be included.

One would be to allow higher cost areas of the country, such as the Southeast, to gain over-order premiums at least worth the transportation costs to bring in Class I milk from another area.

I believe there should be only two classes of milk under the federal order system. I would define Class I as the combination of the current Class I and Class II, essentially covering all fresh products for the domestic markets.

The new Class II could be storable manufactured products (current Class III and Class IV) that are used domestically and exported.

My idea of a new Class I (current Class I & II products) would encompass nearly 50% of the current milk supply, and the surplus production areas could gain the Class I price for Class II (current Class III & IV) milk by sending it to the deficit areas, with deficit area processors paying the freight, while paying the producers from their area the equal value of freight as premiums for all their Class I milk.

Under current utilization, we would have 50% of our current U.S. milk priced in the new Class I. We could then find common ground for a competitive price on the new Class II, meeting at least the cost of importing desired types of manufactured powdered products.

The issue I can't defend is how long it would take U.S. processors to develop the more desirable powders, or whether they would use our excess production to reduce the price, rather than make them to meet the demand.

I wish the California producers would see the value in this, as they are as close to the Asian market as Oceania. They have the potential to make these products, and could supply them at world market prices, reducing U.S.

surpluses (if they do exist). It would be a better price than shipping it East, as ocean freight is cheaper than highway freight.

These issues need to be brought to the sur-

face by the dairy media, so the facts are known – both by producers and our governmental entities. Let's solve the real problems and don't patch the old programs. □

DPAC: 'Cornerstones for Change'

The Dairy Policy Action Coalition (DPAC), concerned the National Milk Producers Federation's Foundation for the Future (FFTF) plan was "on a fast-track" while dairy organizations across the United States were waiting on more details, voted instead to move forward with an alternative plan. Called the "Cornerstone for Change," it identifies what DPAC sees as problems in current federal dairy policy, and outlines suggested solutions.

PROBLEM: The farm-gate milk price is indirectly set by less than 1% of cheddar cheese trade and less than 2% of butter trade on the Chicago Mercantile Exchange (CME). The USDA NASS Survey captures these prices and introduces a 4- to 6-week time lag. The NASS Survey no longer reflects broad supply and demand factors, covering only 20% to 40% of the cheese.

SOLUTIONS:

1. Improve market transparency and dilute CME influence by implementing mandatory daily electronic reporting of product prices/volumes; audit price reporting on a quarterly basis; and establish mandatory inventory reporting, with auditing.

2. Expand price discovery to reflect broad supply/demand factors by expanding the list of plants required to do mandatory price reporting; and adding more dairy products to the list of products reported.

PROBLEM: The federal milk pricing system is broken. Dairy markets today are three-pronged:

1. global, 2. national, and 3. regional. The complex and cumbersome federal milk pricing system is failing both producers and consumers because it: 1. inhibits free enterprise and innovation to be a consistent supplier in the world market; 2. facilitates the concentration of market power; 3. creates complicated order hearing processes that have created such regional issues, as the example of Southeastern producers who are, "in effect," subsidizing the cost to transport supplemental milk from other regions to their deficit market. The current pricing system

was developed before global marketing was an issue.

SOLUTIONS:

Simplify the milk pricing system by reducing four milk classes to two; establishing competitive pay pricing and move away from end-product-pricing formulas that "pigeon-hole" the milk; adopting a federal pricing system that encourages movement of milk to its highest value use; and adopting federal dairy policies that encourage competition, product innovation and market development.

PROBLEM: The federal milk pricing system places all the price risk on producers, and yet producers have no say in how those prices are fixed nor any redress for mistakes.

SOLUTIONS:

Redistribute price risk by eliminating the Dairy Product Price Support Program and guaranteed processor "make allowances"; adopting federal pricing policies that encourage competitive, market-based manufacturing decisions and market development to be a consistent supplier of dairy products in world markets; rejecting the continual process of patching and re-patching the pricing system; moving federal milk pricing methods in a direction that reflects the global realities of the 21st century and passes more value from the marketplace back to producers; promoting development of marketing models around the concept of "producing for a market" as a means of sharing price risk, achieving a price into the future, and managing milk production; and continuing risk management tools, like a voluntary LGM-Dairy margin insurance tool.

FYI ■ DPAC is a coalition of grassroots dairy producers actively participating in the policies and issues affecting milk pricing. The board is made up of active dairy producers – operating dairy farms ranging from 30 to 2,000 cows – from Pennsylvania, Ohio, New York, North Carolina, Tennessee, Indiana and Wisconsin, along with ad hoc members from additional states. For more information, visit www.dpac.net or phone: 800-422-8335.