# DPAC – Addendum to Minutes – Milk Pricing Workshop – Panel Discussion Notes

**March 11, 2010 – 10:20 a.m. – 12:40 p.m.**

*At the Farm & Home Center, Lancaster, Pennsylvania*

**I. Introduction – Rob Barley:**

a. Milk Pricing Action Group (chaired by Barley) planned the Workshop.

b. Focus of Workshop is milk pricing.

c. Supply management is part of that, but this meeting today is the kickoff for the Supply Management Action Group who will begin the process of going through some of these proposals we hear in the second panel.

d. Just like in previous Board meetings, we won't move ahead on something without agreement within the Board.

e. Goal of milk pricing workshop was:

1. Find out what we have total agreement on.
2. Find out what we have consensus on.
3. Identify other items we need more information about.

**II. Informal economist reviews of plans submitted to DPAC – Dennis Wolff:**

a. The economists asked questions that address the ripple effects.

b. Informal reviews were emailed to Board members prior to workshop.

**III. Preliminary report of DPAC Dairy Producer Survey – Sherry Bunting**

a. As of March 9th, 334 producers with 155,531 cows responded from 23 states (range 20 cows to 15,000 cows). States represented: PA, OH, MD, NY, NJ, NH, VA, KY, TN, GA, IN, MI, IA, WI, MN, MO, TX, NM, CO, ID, OR, WA, CA.

*b. Top Concerns:*

1. 69% ranked market transparency in top 3.
2. 61% ranked market volatility in top 3.
3. 55% ranked future profitability & market concentration in top 3.
4. By comparison, 28% ranked over production in top 3.

c. *Top Ranked Priority* – by wide margin

1. 75%, across all regions of the country, ranked top priority as removal of the influence of the CME by taking NASS reporting to next level with daily (electronic) reporting of more products
2. Other highly favored responses: evaluate make allowances and relationship of manufacturing class prices to regional fluid milk.

*d. Pricing concepts:*

1. 86% favored changing the make allowances when yield-boosting technologies like imported MPC are used in making cheese.
2. 71% favored reducing the influence of manufactured product prices on the Class I fluid milk price.
3. 70% favored stronger mechanism for regional Class I utilization.

e. *Producer safety net:* Biggest area of agreement:

1. 77% favor eliminating gov. support purchases to be replaced by solutions that encourage innovation; 6% opposed, 17% unsure.

f. *Supply management:* 52% favor supply management in base-excess question, but 43% oppose having a board set the production limits; 33% favor a board, 24% unsure about having a board.

g. *Global issues:* 90% favored Country of Origin Labeling (COOL) for dairy and tariff rate quotas on currently unregulated dairy protein imports (MPCs).

**h. FINAL REPORT will be provided to Board, posted on website and published in Farmshine by April 2, 2010.**

## MARKET PANEL 10:40 – 11:40 a.m.

**I. Bill Curley, Blimling and Associates – Big Picture Concerns:**

a. Move away from CME spot market and toward daily reporting of actual negotiated transactions between buyers and sellers.

1. The Chicago Mercantile Exchange (CME) is influencable in the short term even if it does get it right eventually over a period of weeks or months.
2. Fixing price transparency won't lead to higher prices, but it will improve decision-making capabilities.
3. The "thinness" of this "spot market" is a real problem for the dairy business and we'd be much better off without it.
4. Individual agendas can move the CME spot market; It is not a functioning marketplace.
5. Not doing buyers or sellers any justice.
6. Unless this is fixed, there will be no meaningful improvement, no matter where we look.

b. Current system of price support purchases and fixed "make allowances" discourage creativity and incentivize over production.

1. Manufacturing investment decisions are made within "riskless environment" versus market demand.
2. Investment capitalizes on security of selling to government.
3. Fixed "make allowances" stymie creativity in the manufacturing sector and contribute to over production because the fixed make allowances, along with government support price purchases, funnel milk into commodity production.
4. Farmers take on the market risk as expanded commodity production that is not market-driven is in reality spread out over their milk checks in the blend price through pooling.

c. Instead of adding another layer of inefficiency, smartly unwind the system to get the producer more directly aligned with the customer to "right-size" the supply of milk.

1. Find new markets instead of commodity guarantee mindset.
2. Pooling takes the burden off the one who creates the problem.
3. Notion that cheddar cheese has a lot to do with what milk costs in the East is an idea whose time has passed. (Class I "Mover" is currently based on Class III driven by CME cheddar cheese).
4. Look at Federal Order rules that have been gradually changed to minimize the cost associated with bringing in outside milk …What is the regional market advantage?

**II. Marvin Hoekema, Dairy Decisions, LLC (based in California):**

a. It's important to fix the whole thing, not just a piece of it

b. Roll back "make allowances"

   1. This would distribute a greater share of the price risk throughout the supply chain. Currently, the dairy producers have all the risk.

c. Need better USDA NASS reporting – electronic reporting needed

   1. Not just daily price reporting but also need quarterly milk-flow reconciliation by NASS – Include 100% reporting on dairy commodity price points along with sources and uses report to know who is selling milk and where it is sourced and used.

d. Concentration of market power must be addressed. This occurred rapidly ever since Federal Orders were consolidated in 2000.

e. Exports: New Zealand's Fonterra has 100% influence on U.S. exports through contractual agreement with DairyAmerica.

   1. Fonterra has 70% of the world market and half of that product comes from remarketing from other nations, incl. DairyAmerica.
   2. When they need it, they get it from us, and when they don't need our product, they let it back up into the U.S. market. So DairyAmerica becomes "the whipping boy."
   3. U.S. dairy support price purchases position U.S. as the world balancer.

**III. Ed Gallagher, vice president of planning and regulatory policy for Dairylea Cooperative, Inc., based in Syracuse, New York.**

a. More information, faster, is always better… so electronic reporting is where we should be.

b. Make allowances on Class III do offer an automatic margin for big new plants that have a "lower make."

c. But bottom line is we would still have the prices we have today.

d. Need to fine-tune the income safety net with better ways to control volatility as the industry grows demand.

e. Eliminate price support purchases, <u>but</u> must add "income safety net" to replace support price purchases.

f. DFA has a Growth Management Initiative:

   1. Supply management program with mandatory contribution to a private entity with a board made up of "mostly" dairy producers.
   2. More flexible and responsive than a government board. (Turn on a dime)
   3. Funds could be used for herd retirement, heifer reduction, and authority to implement base / excess programs (similar to Holstein USA's Dairy Price Stabilization Program).
   4. Devil in details. Need a program more flexible than a hard-core government program. DFA's Initiative would be flexible.

**IV. Kurt Williams, general manager for Lanco-Pennland Quality Milk Producers Cooperative based in Hagerstown, Maryland.**

a. Defining our markets is #1 issue: We can't value our product without defining our markets. Price structure should follow % use of more products.

b. Even the Commodity Futures Trading Commission (CFTC) acknowledges that the CME spot cheese, butter, powder "market" is not a market.

   1. One single trade moves the market.

   2. Block cheddar (CME) has diminished significantly in market share… While fresh Italian / specialty cheeses keep increasing in market share.

      a. All pay Class III price, even if making higher value, higher moisture cheese, which they don't hold or age.

      b. Mozzarella market is like Class I market – Made to order, but dairy farmers are not getting that value from the higher return on mozzarella.

c. Need broader reporting—Part of price discovery is how to determine Class I "Mover" and to review Class I Location Differentials.

   1. Currently, Class I is being set on manufacturing price and yet major manufacturing plants live where there are no people (and consequently a low Class I use for fluid drinking milk).

   2. Class I "Mover" must be stabilized, especially if dairy product price supports are eliminated.

   3. Modify to regional Class I "Mover."

   4. Keep the uniformity of different Class I values for different counties, maybe just enhance and update the differentials. Need to ensure "orderly marketing." That's the purpose of the differentials.

d. Current system makes U.S. the balancer of the world market.

   1. When Fonterra doesn't have a better date, we are a pretty girl.

e. Can't manage growth until we understand what role we'll play in world market, which we can't as an industry (or you as a producer) plan on.

f. Be realistic. What can we accomplish?

g. National Milk Producers Federation (NMPF) is going to "drive the bus."

h. Can't be the turtle: Influence the people that are in the game.

   1. Most effective way to influence is like basketball: Small teams can win by playing the whole court:

      a. Press

      b. Be everywhere

      c. Play everything.

   **2.** Complex discussion needed.

**SUPPLY / DEMAND PANEL 11:40-12:40 p.m.**

I. **Amanda St. Pierre (Dairy Farmers Working Together DFWT) and Doug Maddox (Holstein USA) – Dairy Price Stabilization Program (DPSP):**

a. (Maddox) Concept is to do one thing – Another downturn is coming and will be a killer on the back of 2009. Can do this supply mgmt without opening Farm Bill.

b. (Maddox) Holstein DPSP proposal is about supply-and-demand: Economics 101.

   1. Base-Excess plan works off projections of domestic and international market supply-and-demand.
   2. Global demand expected to increase, but I for one, do not want to produce for it until I know it's there.
   3. Plan provides an incentive not to produce or to produce depending on market conditions of supply-and-demand.

c. (Maddox) Holstein DPSP proposal <u>does not</u>:

   1. Set a minimum price or fix the Federal Order system
   2. Change the milk standards (SCC, solids, etc)

d. (Maddox) It's one more tool in the toolbox to prevent the drastic drop in prices.

e. (Maddox) Milk produced over the farm's base and over the allowable growth rate would be subject to market access fee.

   1. Southeast thinks they shouldn't have a market access fee because they are milk-deficit region.

f. (St. Pierre) One thing supply management (Holstein DPSP) does is: It allows us to exist for these other conversations that need to happen on pricing.

   1. Allows us to stay in business and take back our industry.
   2. Allows us to exist another day to have this debate on our industry's future.

g. (Maddox) Holstein DPSP is our "first step."

   1. He doesn't disagree with Sen. Bill 1645 (Specter-Casey)… but says that it won't get done.

h. (Board) If over base for 1 year, does that become farm's new base the next year?

   1. (Maddox) Clarified that the producer base is a "rolling base." If over base for one year and pays market access fee that year, farm establishes new base at the higher level for the next year.
   2. If we see base moving up and hurting the program, can set the market access fee high enough that they can't afford to do that.
   3. And, when have a year like 2009, allowable growth rate may be zero or it may be a negative number where everyone must cut production by a certain % to avoid a market access fee.

i. (Board) Who implements Holstein DPSP?

   1. Elected board made up of 75% dairy producers – following DFA concept of a 30-man board (24% dairy producers).
   2. Concept of setting a milk price trigger is being kicked around.
   3. Producer Referendum in 3 years—reform / stop if not working.

j. (Maddox and St. Pierre) Other plans:

   1. CWT plan, DFA plan and similar Growth Management Initiative, AgriMark plan. Looking at how we can work together.
   2. Cornell being asked to model these plans.

**II. Steve Mandl, Dairy Producer, Jamestown, PA (previous expertise in financial markets) – Dairy Price Index (DPI) pricing plan for wholesale milk:**

a. Use Dairy Price Index-DPI (from Consumer Price Index-CPI) much like indexes are used for bond portfolios on financial markets.
    1. Dairy and related products section is 1% of CPI
    2. DPI represents 2500 different products.
    3. Milk is 30%, cheese is 30%, other categories make up the rest.
    4. DPI includes dairy substitutes.
    5. Reported monthly by Bureau of Labor Statistics.

b. Base price in first month of operation would be USDA ERS cost of production plus a 10% margin. After that, DPI %-change would be the milk price "mover."

c. Incredibly simple and transparent program – anyone can calculate it.

d. Market oriented: Supply and demand balanced and driven at consumer level.
    1. Processor and retailer retain full control to raise or lower the price throughout the supply chain right to the consumer.
    2. Clears product with better price to consumers when supply exceeds demand.
    3. Returns more value to producer when demand exceeds supply.

e. Captures "missing" value, incl. skim from 1%, 2% and nonfat milk bottling. How does that cream get valued in our price now? (Ref. Hoard's Dairyman article)

f. Fate of farmer would more closely align with processor and retailer.

g. At a minimum: This could be one portion of how to price milk.

h. Hard to manipulate a system like this.

i. (Board) How to manage supply if milk price starts at $24 cost of production?
    1. (Mandl) Not a cost of production guarantee. Starts at COP but then the DPI would adjust according to supply/demand.
    2. Supply management aspects of this plan still being tweaked, but based on allocated "Dairy Shares," giving producers the right to sell certain quantity of milk (current prod.) at calculated price.
    3. Possible "insurance fund" like FDIC for banks, used to buy producers' milk if processor shuts down or goes out of business.
    4. Also, market oriented pricing by DPI would manage supply all the way through to how product is priced to consumer.
    5. Calculated price would remain no matter the supply; BUT, increase/decrease in milk supply would be negotiated with the processor because the processor would not be required to take on more milk if producers want to expand.
    6. Dairymen and processors would need to work together to implement more efficient and innovative ideas.

j. (Question) Graph showing "asymmetric" pricing where wholesale milk price falls and retail market basket stays relatively constant… Is this why rules of market supply and demand are not working?
    1. Farm milk price down 45% but DPI down 12% Mar-Aug 09.

k. (Question) Who would dictate orderly marketing since most powder facilities that balance the market are owned by cooperatives?
    1. (Mandl) Federal Milk Marketing Orders (FMMO) would continue oversight; milk would go to highest use at DPI-adjusted price and excess would be negotiated.

**III. Harry Stugart, Dairy Nutritionist, based in Butler, PA—Ration-All Milk Pricing—Two-tiered market-oriented milk pricing proposal:**

a. Developed this plan 10 years ago – because of irrational pricing based on small changes in supply/demand. "Success of any plan is to keep supply and demand in near perfect balance."
    1. If there is only 1% too much milk… over 6 months that 6% too much storable product sitting somewhere.

b. This plan stabilizes volatility on 90% of milk supply by using 60-month moving average of volatile "market" prices, and projecting out 12 months for greater stability all the way from the producer to the consumer.
    1. Trend price evens out volatility, but producers still "hear what market is telling us."
    2. Stability on 90% of supply allows farms to cash flow, budget, and plan.
    3. Value increase or decrease on 10% of supply helps producers make right decisions. Right now, producers have only one choice: Make more milk to cash flow in a down market or capitalize with more milk on an up market.

c. Open bidding process would be used for over-base milk (generally 10% of milk supply). This would be transparent, foster market competition, and could not be manipulated.
    1. Bids due to FMMO administrator by 20th of month. Summarized and announced by 25th of month for next month's sales.
        a. Dairyman can decide, based on that announced price, whether or not to ship the over-base milk.
    2. Bid process on over-base milk provides ongoing transparency of market needs in each area of the country.
    3. These bids would value the actual milk & components according to market demand via use in a variety of products in each Federal Order VS. current system's use of NASS survey of a few products, which are blended into one price for the entire country.
    4. Bid process provides more market transparency directly between producer and processor, allowing each to react to signals.
    5. Bid offers would reflect processor need for milk, not NASS survey of inventory or miniscule trades on CME.
    6. Bidding process on approximately 10% of the milk would provide a mechanism to adjust Class I location differentials—automatically—because fluctuations in cost of transportation and regional supply/demand would dictate processor bid offers instead of arbitrary review of location differentials.
        a. Processor bids for milk would consider cost of transportation to bring milk in from another area.

d. Eliminates need for gov. support purchases, MILC payments, make allowances.
    1. No make allowances means processors have no incentive to make products for storage or gov. purchase—both of which currently drive price down, longer, and interfere w/ signals.

e. Doesn't deal directly with imports/exports; allows U.S. to be more competitive.

**IV. Arden Tewksbury, general manager of Pro-Ag, author of S. 1645 (Specter-Casey bill) The Federal Milk Marketing Improvement Act of 2009.**

a. Plan is supported by at least 2,500 dairy farmers.
b. Pro-Ag authored the bill – Not a lot of $ coming into Pro-Ag, but we do fundraisers and talk with thousands of consumers. They can't understand why dairy farmers are not getting a fair price.
c. Current system uses a small portion of producer milk against the producer to destroy the price on the rest of the milk.
d. This plan simplifies to Two classes: Class I = Fluid. Class II = Manufacturing.
    1. Class II manufacturing price for U.S.-produced milk would be national average cost of production (USDA-ERS monthly figures) adjusted quarterly.
        a. Pro-Ag believes it's time to give credence to cost of production in milk pricing.
        b. Remember: 25% of U.S. milk produced in California where Class I utilization is 16%. That's a whole lot of manufacturing milk.
    2. Class I fluid would have existing Location Differentials added.
        a. State of California and other unregulated areas would be assigned a Class I Differential by Ag Secretary.
e. Federal Milk Marketing Orders (FMMOs) stay intact – still responsible for determining component value of milk.
f. Discontinue "make allowances."
    1. Make allowances "came out in the open" with Order Reform in 2000. Farmers always paid it… just now you know it.
g. Inventory supply management aimed at preventing build up of domestic milk products and prevents foreign products from destroying U.S. prices paid to dairy producers.
    1. This is achieved by requiring imports and exports to be in balance before the inventory management program can be implemented at any given time—thus removing the import imbalance before addressing the domestic supply concern.
h. Inventory management funded by all dairy farmers.
i. Inventory management consists of cutting in half the Class II manufacturing cost-of-production price on up to 5% of all producer milk (second tier).
j. If this is insufficient to manage the supply, Secretary of Agriculture may reduce the price paid on milk production that exceeds each producer's prior year base.
k. New producer may produce up to 3 million pounds/year before being subject to the provisions of inventory management. This applies only to first year and is capped to apply to young farmers entering the business.
l. There is no cost to USDA for this program. 100% farmer funded.
m. Changes how producers vote on FMMO amendments. No more "all or nothing" vote. No more cooperative "bloc voting."
n. Dairy farmers continue to pay hauling charges because hauling is included in the USDA ERS cost of production price, which is the Class II base.
**o.** Other ideas we heard today might do it… But our plan will do it. Our goal is we want dairy farmers to get a fair price and consumers want to buy milk at a fair price.