A NEW APPROACH TO FEDERAL MILK PRICING 3/6/10

GOALS

In the future, the price of raw milk must be stabilized at a sustainable level so that the dairy industry can survive and thrive. With the inherent volatility of the current price structure, only traders and processors are benefiting and dairymen are being forced out of business.

Pay prices to dairymen must be stabilized if we are to maintain our industry and preserve markets.

It is important from a food safety standpoint, as well as from a homeland security standpoint that a wholesome and abundant supply of dairy products be produced domestically for American consumers.

Price paid for raw milk must reflect true supply and demand.

Government involvement must be minimized.

Any milk pricing policy must allow our country's dairy industry to participate in world markets.

Any milk pricing policy must allow individual dairymen to react, as they see fit, to market conditions without government or other interference.

Policy must prevent market manipulation by traders or processors from determining the price of all dairy products.

Policy should not discriminate against any dairy based on size, location, or management style.

WHY A CHANGE IN PRICING POLICY IS NEEDED

When an excess supply of raw milk occurs, the price drops and cheese plants and powder plants can then dramatically increase production, using cheap raw milk, and then stockpile finished products. With the "make" allowance funds available to them, they make a profit at the expense of the dairymen right off the bat. Further, the finished products being held in storage serve to keep pay prices to dairymen at low levels when inventories are reported and factored into the current pricing formula.

In the future, considering the federal budget deficit, it is unlikely that adequate funding will be available to service existing dairy programs.

MILC(Milk Income Loss Contract) and DPSP(Dairy Price Support Program) do not allow for market signals and supply/demand indicators to work. MILC pays producers when supplies are long and prices are low to continue producing and adding to the problem oversupply. Under

DPSP, when world prices drop below support levels, we lose our export market and the problem of excess supply and low prices is worsened.

The NASS(National Agricultural Statistical Service) survey price, a major input in the pricing formula, does not have a direct connection to retail prices for milk and cheese and other dairy products, so there is no correlation between the price the dairyman receives for raw milk and the price paid by the consumer at the supermarket. During this past year dairymen consistently received less for their milk than the costs of production and many dairies were forced out of business. Extremely low raw milk prices were not reflected in consumer prices for dairy products at supermarkets. Processors and cheese makers enjoyed one of the most profitable years ever, largely at the expense of the dairy producers.

Current milk pricing policy does not factor in any costs of production. Last year's disaster for dairy producers was actually worsened by rising feed costs and fuel costs that occurred as a result of federal ethanol subsidies and the conversion of feeds to fuels. Future milk pricing systems must be linked to production costs!

SUGGESTED NEW MILK PRICING FORMULA

Part 1. Sets price for 90% of rolling 12 month average base production… readjust every 6-12 months….fair and stable base pricing

A. Cost of production: Feed, fuel, utilities, labor, interest, environmental, regulatory
   Suggested weight 25%
B. Average retail prices of milk and other dairy products…True supply/demand
   Suggested weight 25%
C. Previous period 90% formula price…..This dampens volatility.
   Suggested weight 25%
D. Previous period Part 2, 10% formula price…reflective of current markets, suggested weight 25%

Part 2. Sets price for 10% of rolling 12 month average base production….readjusted every 1-3 months…fine tuning mechanism, controls any surplus quickly

A. World powder price, Suggested weight 25%
B. World cheese price, Suggested weight 25%
C. Competitive pay prices for raw milk, as determined by actual market activity, 25%
D. Milk futures and CME(Chicago Mercantile Exchange)Pricing, 25% weight

EXAMPLES

Dairy "A"
Operating at 100% of historical production
Market conditions at excess supply of 3%

Under Part 1: 90% of milk gets base formula price

Under Part 2: Of this 10% of total production, 7% of total production will be paid out at the reduced level formula price, which will be considerably less than the part one price.
For the other 3%, the dairyman will receive no compensation, but he has 30 days to make his 3% surplus disappear or he may donate it for processing and distribution in disaster relief or feeding programs. This will avoid surplus production and it will be a great public relations move.

Dairy "B"
Operating at 105%of historical production
Market conditions at excess supply of 3%:

Under Part 1: 90% of milk gets base formula price

Under Part 2: Of this 10% of total production, 7% of historical total production will be paid out at the reduced level formula price, which will be considerably less than the part one price. For the other 8%, the dairyman will receive no compensation, but he has 30 days to make the 8% surplus disappear. This will effectively discourage growth during times of surplus.

Same dairy, same production, Market conditions at shortage supply levels:

Under Part 1: 90% of milk gets base formula price.

Under Part 2: All 15% gets paid at the Part 2 price, which may, during these times, be higher than the Part 1 price, depending on the conditions of supply and demand in the world market. It would not be necessary to divert or process any surplus product for donations during these times, as there would be no surplus.

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