



Reporter's Notebook
2009-2011

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Dairy's 3-M's

Markets
Margins
Management

2009 changed everything

- Farmers lost avg \$100/cow/month & billions in equity
- Credit issues compounded problem
- **Farmers' share of consumer dairy dollar fell from 42% in 2002 to 27% in 2009-10**
- Supermarket sticker shock (Fluid milk & butter eventually moved lower with farm milk price BUT cheese, ice cream and other products MOVED HIGHER)
- Supply management discussion went mainstream
- Channel consolidation: market power / antitrust
- Poor price discovery (CME manipulation)
- Support Program & MILC poor safety net; prolonged downturn
- U.S. balanced the world supply
- Local economies: tax base and dairy related jobs at risk
- **Farmers' Message: Pricing Overhaul**

Grassroots movement

Producers showing loss of faith in cooperatives and NMPF as their "voice." They organized regional meetings and had small follow-up groups; kept direct link to their legislators

EXAMPLES MEETING W/ LAWMAKERS

8 Different County Groups in PA
1 for Holmes / Wayne County OH
Led to formation of DPAC (more later)

Top of Mind

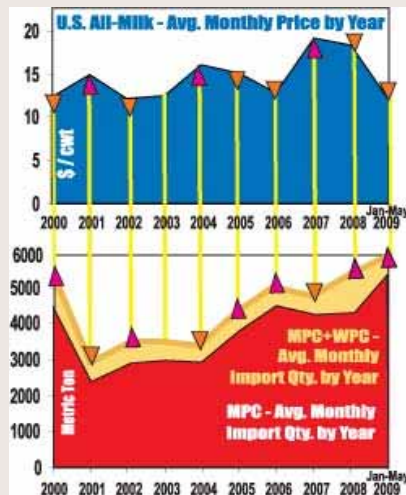
- **Antitrust investigations & workshops**
- **Imports / Exports:** Fair Trade? Fair competition? Is it dairy? Are we marketing?
- **Standards of Identity:** (Follow up on 2001 GAO reports (FDA “withholding enforcement” or “using enforcement discretion.”))
- **Enforce and reduce SCC limits**
- **Hauling charges?** States try but can't unless it's national
- **Mandatory, audited NASS inventory reports**
- **Price Discovery and Pricing Overhaul**
 - Less CME influence
 - Mandatory daily reporting on more products... What is my milk worth in the market on any given day?
 - Example: Fresh Italian cheeses are more than 40% of cheese market but are not reported.

MARKETS...

MPC + WPC Imports vs. All-Milk price

MPC = Milk Protein Concentrate; WPC = Whey Protein Concentrate

- Imported MPC + WPC has inverse relationship with All-Milk price
- During USDA's Class I hearing (2009), Fonterra testified: “...**whey is used in nearly identical products as MPCs,**” and testified that “**whey production is primarily domestic (U.S.), but most MPCs are imported...**”



Dairy Product Price Support failed

World dairy demand grew 1.5% in 2009! Where were we?

Oct. 1, 2008 - Oct. 1, 2009.
CCC bought 2.8 mil. lbs NFDM
in addition to butter

****Most powder purchased
Oct. 1, 2008 - April 2009 when U.S.
imports of MPC's were at record
levels December 2008 - March 2009
before leveling off in June of 2009****

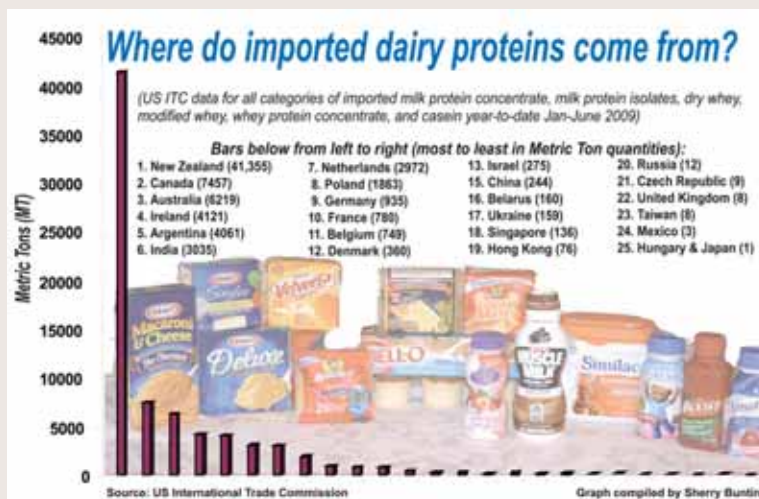


NZ price improved in summer of 2009, While our gov.
bought an additional 132,276 lbs powder from Oct. 1, 2009
through Jan. 2010.

Sources & Uses

Safety concerns: See refusals at

▪ http://www.accessdata.fda.gov/scripts/ImportRefusals/ir_index.cfm



What's the difference?

- Dairy products have tariff-rate quotas
- Dairy ingredients (like MPC) no tariff-rate quota
 - Were not a factor when GATT agreements were negotiated more than a decade ago.
- Inter-related factors:
 - Imported MPC behaves differently in the market than imported cheese.
 - Replaces NFDM or whey in various products
 - Used in many new products (functional ingredients)
 - Used to standardize cheese milk – 30% boost in cheese yield per cwt of milk
 - New cheese types skirt the federal “standards of identity”:
 - *Example: Pizza Cheese vs. Mozzarella*
 - *Kraft American cheese “food” vs. “product”*

Dozens of codes & categories

- **HTS 0404** – “Milk Constituents”
 - Frozen desserts; protein fortified, low-calorie dairy beverages and yogurt; Infant formula (vs. WPC)
 - Non-standard cheese (pizza cheese / process cheese)
- **HTS 3501** – “Casein Derivatives, Casein Glue”
Mixed uses:
 - Dairy Foods: Example: “low carb / high protein” bars/drinks
 - Non-Dairy Foods: Example: non-dairy coffee creamers, etc.
 - Non-Food: cardboard coating, other industrial
- **HTS 2106** – “Textured Proteins”
 - **This Category is increasing** / *Example:* Fonterra’s Protein wafers 20% rice / 80% MPC or Whey Protein
 - Fonterra tried to import under duty-free 3501 but U.S. ruled must be 2106 (some duty paid)

NFDM vs SMP what's the difference?

- SMP more standardized
 - (protein 34%)
- NFDM more variable
 - (protein 34 to 37%)
 - Quality issues
 - Line speeds
 - Customer relationships
 - Do we care what the customer wants?



Exports

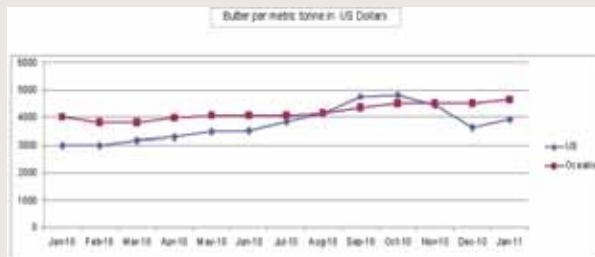
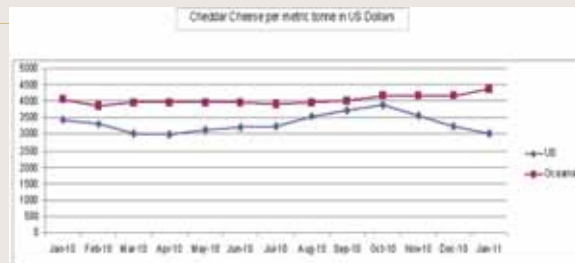
- **Record U.S. dairy exports in 2010**
 - Represents nearly 15% of production on solids basis
 - U.S. Export Volume Up 19% over the past 7 years
 - U.S. Exports topped Imports in 2007, 2008, 2010
 - 2011 continued record pace / exports moving at market
 - CWT discounts on less than one-third of total exports
- **NEW TRENDS:** China imported 7x more Whole Milk Powder (WMP) from NZ in 2010 vs. 2008 – Trend continued in 2011
 - China imported 64% more SMP (NZ & US) 2010



Can U.S. Farmers compete at the World Price?

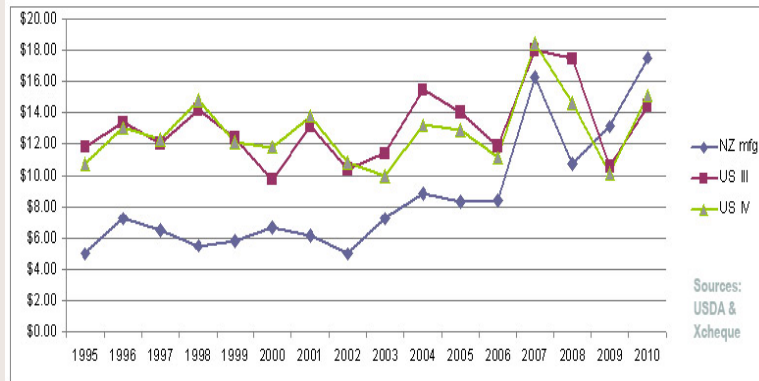


Can U.S. Farmers compete at the World Price?



Can U.S. Farmers compete at the World Price?

US & NZ Price comparisons based on US Dollar and 3.5% Fat & 3.0% Protein



Demand shifts / Factors we can't control!

* Ice cream – smaller containers

2008: downsized to 1.5-1.75 qt vs. 2 qt conventional size

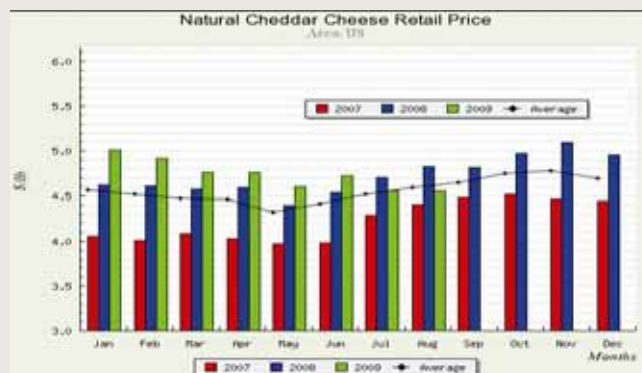
- National brands: Reduced container size in 2008 due to higher milk prices.
 - Ice Cream containers are still smaller at 1.5 to 1.75 qt vs. 2 qt
- Cheese: 1 slice or 2 on the McDonald's double cheeseburger?
- Food industry formulations (frozen entrees / restaurant trade)
- Stocking rates – product mix – inventory management
- **Less product @ same price = MORE PROFITS**
- **“Unseen” demand hit – lands at the farm level**

Supply shifts – CME drives farm price

- Did increased cheese yield per cwt of milk help drive “over” production? (MPC usage boosts yields 30%)
- Cheese is the driver in reduced raw milk price paid to farmers
 - CME limited # of traders and actual sales, BUT this dictates NASS Survey Price used by Federal Milk Marketing Order to set minimum milk price paid to farmers.
- Same or increased retail price paid by consumers!
- Dairy farmer pays ‘make allowance’ (total \$2.77/cwt subtracted in the product formula price)
- **100% OF PRICE RISK IS ON THE DAIRY FARMER**

Retail cheese prices were higher than 2008 for first half of 2009

Notice... Cheese price started going up in Oct/Nov, which is when Milk Price was heading downward and that is when MPC importation was ramping up Nov through Apr.



Domestic Use

2009 vs 2008

- Cheese consumption up 2.6% (all categories)
 - Jan-July up 4%
- Butter consumption up 17.6%, but manufacturer's stocks were UP even though production was DOWN. Why? Imports of butter and milk fat were WAY UP.
- Powder consumption down 20%; Government CCC purchases; U.S. pulled out of world market at the end of 2008 to get 5 cents more per lb. By selling to Uncle Sam.

Fluid Milk:

- FLUID MILK consumption
 - **2009 fluid milk sales were UP 1.6% over 2008**
 - **2010 fluid milk sales were DOWN 1.4% below 2009**
 - **2011 fluid milk sales DOWN 1.5% first 9 mos. 2011**

Make allowances = \$2.77/cwt.

cheddar / butter / NFDM / whey

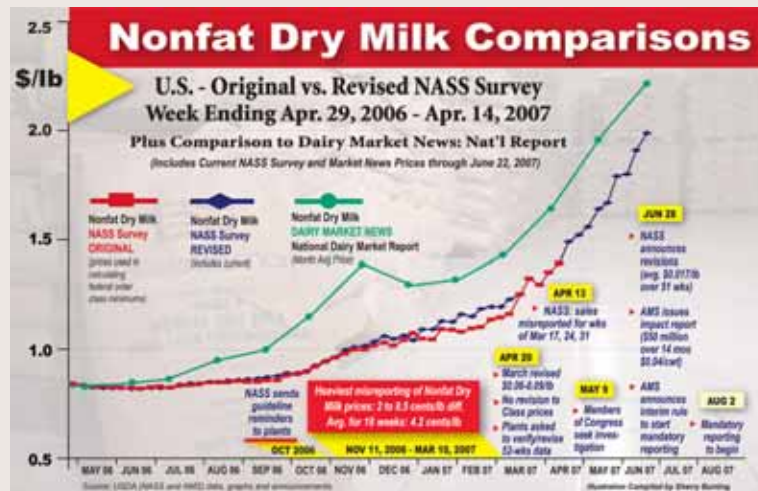
- Increased by 50 cents 2009. Former Ag Economics professor Ken Bailey predicted lower producer prices as a result – more processor complacency bad for market and bad for farmers.
- Dr. Ken Bailey objected: *“My bottom line is: If prices are bad right now (2006) and they take off another 50 cents based on an administrative hearing, our producers will find that to be outrageous.”*
- 2006-07 hearing, Bailey also said: *“If cheese make allowances are so bad, why are we building more cheese plants? We need to find other product outlets for these components.”*

'Make allowance' complacency

- Sellers have no incentive to sell higher
- Processor focus: being more efficient on costs than the guaranteed make allowance pays them.
- Lack of incentive for true product innovation in the U.S.
- Fonterra joint ventures "fill the gap." They are looking to U.S. as big market for New Zealand products.
- U.S. starting to take back "some" marketing control.
- Need to be market-savvy: World wants SMP – we make NFDM
 - U.S. NFDM often not up to world customer spec
 - Government Support Price program adds to complacency
 - Built-in "margin" (make allowance); fail safe buyer (Uncle Sam)

Why reporting & auditing is so important

Remember the mis-reported powder?



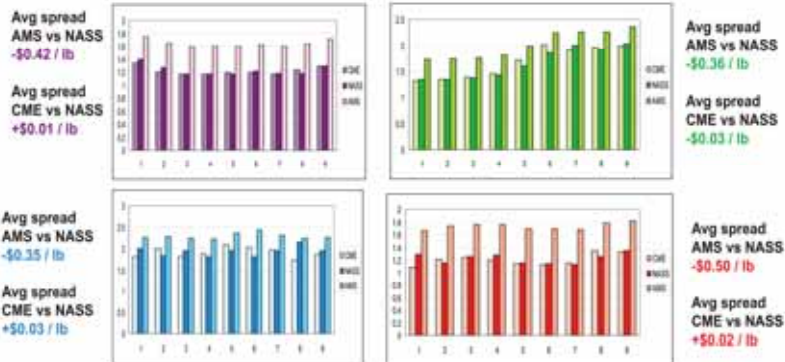
Who is against daily reporting?

- DairyAmerica submitted USDA rulemaking comments – largest opponent
- If I sell you 100,000 lbs of NFDMM for delivery next week at \$1.40/lb and 100,000 lbs of NFDMM for delivery in 31 days at \$1.70/lb ... the net price is \$1.55/lb but only the \$1.40/lb gets reported to NASS!

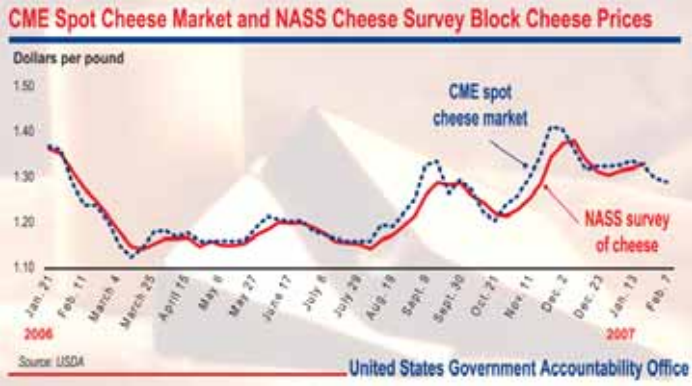
Wider spread NASS vs Dairy Market News

CME vs NASS vs AMS MARKET NEWS 2006, 2007, 2008, 2009

*In downcycle: spread between CME & NASS Survey narrows; spread between NASS Survey & AMS Market News reported spot price widens
In upcycle: spread between CME & NASS Survey widens; spread between NASS Survey & AMS Market News reported spot price narrows.
The 6- to 14-cent wider spread for 2006 and 2009 versus 2007 and 2008 = \$0.60 to \$1.40 per cwt. impact on the blend price.*

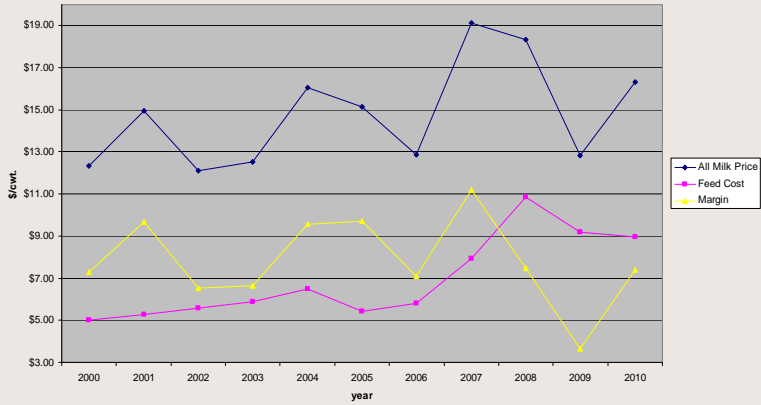


Cheese and the CME



“Margins” vs. Price

All Milk Price, Feed Cost, Margin 2000-2010



Proposals – NMPF
Foundation for the Future (FFTF)
“Dairy Security Act” / REFRESH Act

SAFETY NET

- **End Dairy Product Price Support**
 - Around since 1949
 - Expected to be terminated 11 years ago!
 - Obstacle to being a consistent supplier on the world market
 - Obstacle to product innovation
- **End MILC**
 - Around since late 2001
 - Made payments in 50 out of 109 months (range 3 cents to \$2)
 - Favors smaller farms
 - Not effective enough when margins are stressed by higher feed costs
 - Expensive for Federal Government to maintain

REPLACE with Margin-triggered national Dairy Producer Margin Protection Program (DPMPP) and Dairy Market Stabilization Program (DMSP)

**Dairy Producer Margin Protection
& Market Stabilization (hand-in-hand)**

- National margin between feed cost and milk price
- Base level protection triggers at \$4 margin
 - Would have triggered a payment in 8 months of 2009
 - No payment would have triggered in 2006 or 2003.
 - ****Base level covers 80% of production “base”**
 - ****Option to sign up as a “growth dairy”;** allows readjustment of base / premium is higher.
 - Producers can “buy up” to cover higher margins on up to 90% of their base milk – Rates are fixed for 5 years.
 - Base for the “insurance” is the highest of 3 years prior to Farm Bill implementation: Locked in for 5 years.
 - Sign up first year – locked in for 5 yrs – USDA bills annually
- **Market Stabilizing Penalties trigger on the same “margin” as the Protection Program**

Stabilization Program

If you sign up for protection, you are regulated on production at same triggers

- When margin hits \$6 / producers are paid for 98% of their base (up to cap of 6% penalty)
- When margin hits \$5 / producers are paid for 97% of their base (up to cap of 7% penalty)
- When margin hits \$4 / producers are paid for 96% of their base (up to cap of 8% penalty)
- **DIFFERENT BASE than protection program:**
 - When margin hits trigger for 2 months; producer gets letter and 30-day notice of non-payment for 2, 3, or 4% of base.
 - Base is rolling avg of previous 3 months before trigger
 - OR can choose base as same month previous year.
 - Choose at beginning of year for whole year.

Where does the money go?

- Processors still pay for the milk
- Money collected by MA for “demand enhancing fund” run by a board
 - Cheese purchases for food assistance
 - Export enhancement?
- All over-order premiums on “penalty milk” also withheld
- Class I bottler subsidizing cheese purchases?
- Specialty products subsidizing commodity purchase?
- Price risk still 100% on dairy farmer

Impact of Dairy Security Act (CBO vs. Real World)

- **Taxpayer risk: \$3 bil. more over 5 years**
- **Reduces Exports**
- **BUT CBO SCORE SHOWS \$131 mil. savings over 10 years.**
- CBO Score does not include the liability risk to taxpayers – no private insurers – all risk is on taxpayer (protection payment) and farmer (supply management)
- Tailor-made for “Super Committee” because it SCORES!

Less Volatility comes at Hefty Price!

Stephenson / Nicholson Analysis

- **Reduces Net Farm Operating Income for ALL FARMS = \$10 to \$14 billion over 5 years**
- Reduces milk price by avg \$1 / cwt
- Small farms exit faster / more rapid consolidation
- Stabilization Program would be active 40 to 45% of the time = more dependence on government.
- ****250 to 600 cow dairies most vulnerable (up to 61% loss in net farm operating income)****

Peterson's agenda?

"We are hoping to keep stability in agriculture so food prices don't double... We're trying to make sure the United States produces the cheapest food."

And yet... exports decline?

NMPF Federal Order Reform

Will be handled by administrative hearing

- Competitive price instead of product formula price to determine Class III price
- NMPF calls it a 2- class system: fluid and manufacturing
 - **In reality it is a 4-class system**
 - **Make allowance is retained for Class IV**
- **No minimum manufacturing price / No component values**
 - Class I differentials pooled
 - Class IV receives "credits" (reduce competition for milk)
 - Class II – add 30 cents to Class III weighted competitive average
- Butter and powder plant credits
 - credit back the lowest competitive Class III price
- Hearings for balancing and transportation credits
- National producer referendum / Not Order by Order

Dairy Industry Advisory Committee

- 109 page report to Sec. Vilsack
- Some good ideas:
 - Devise Profitability benchmark
 - Farm Savings Accounts (tax deferred profits)
 - SCC down to 400,000 in 48 months
 - Review Federal Order Pricing
 - Split vote 9 to 8 on “growth management”

Key issues identified by DPAC

- **Market Transparency / Price Discovery #1**
- **Market Power** (*Farm to retail margin / competition*)
 - Dairy farmer's share of the consumer dairy dollar decreased from 42% in 2002-04 down to 26% 2009-10.
 - 2009 farmers lost \$100/cow/mo. VS. Retail / processing / coops reporting record profits.
- **Exports / Imports – Product Innovation**
- Dairy markets are global, national **and regional**
 - Diversity of farm sizes is critical to jobs and infrastructure.
 - Dairies need farm-specific tools not one-size-fits-all program.

DPAC – Casey’s Dairy Advancement Act (S. 1682)

▪ Cornerstones for Change

- Eliminate Dairy Product Price Support
- **Producers choose:** MILC (cap 2.4 mil lbs) OR subsidized LGM-Dairy Insurance (cap 3 mil lbs)
- Producers can buy additional LGM-Dairy w/o subsidy
- Sec of Ag to implement two-class pricing by component values (report to Congress / Econ. Analysis of farm profitability)
- Increase market transparency with improved reporting
- Loan fund for processing equip / innovation (co-ops & proprietary)

Separate from bill:

- Market Cow Bonus program (under eval)
- Reform “bloc” voting in Federal Orders

Dollars and sense?

What about liability?

- Dairy Advancement Act (S. 1682): CBO Score PENDING
- Internal analysis shows that if **LGM-Dairy in DAA** covered 42% of the U.S. milk production, the government liability and taxpayer exposure would have been **\$480 MILLION in ‘09 / zero in ‘03 & ‘06.** (17-pg. Report avail)
- Compared with 42% of U.S. milk production covered under the **Dairy Producer Margin Protection Program in the Dairy Security Act**, which would have carried government liability and taxpayer exposure in **excess of \$5 BILLION in ‘09, plus \$1 bil. in ‘03 & \$550 mil. in ‘06.**

NDPO and ProAg

- Federal Milk Marketing Improvement Act
- Introduced by Sen. Casey (S. 1640)
- 2-class system
- Sets manufacturing class price using USDA national average cost of production
- Class I differentials stay the same
- Two-tiered pricing system when over-supply kicks in
- Supply management cannot trigger if imports are greater than exports.

NY's Senator Gillibrand

- Introduced two bills
- One stops supply management (no funding to administrate)
- Seeks regional adjustments for areas that are deficit
- Provides MILC until the Dairy Producer Margin Protection Program is implemented
- Some reporting changes

Critical questions? Let's peel the onion

- Can U.S. dairy producer compete at the "world" price. (World price was higher than U.S. price 2009-10!)
- World Dairy Demand grew 1.5% in 2009: U.S. walked away and built inventory instead.
- Does the U.S. produce too much milk? (Commercial disappearance exceeds U.S. production)
- Canada has a separate "export class," why can't we? (WTO rules: Canada's imports are used only for export – in-and-out)
- Does it make sense to add a layer of government-supply management on top of a broken system?
- What policies will position producers to be profitable?
 - **Opportunities vs Guarantee**
 - **Margin "tools"**
 - **Producers are getting involved**

Cure worse than disease?

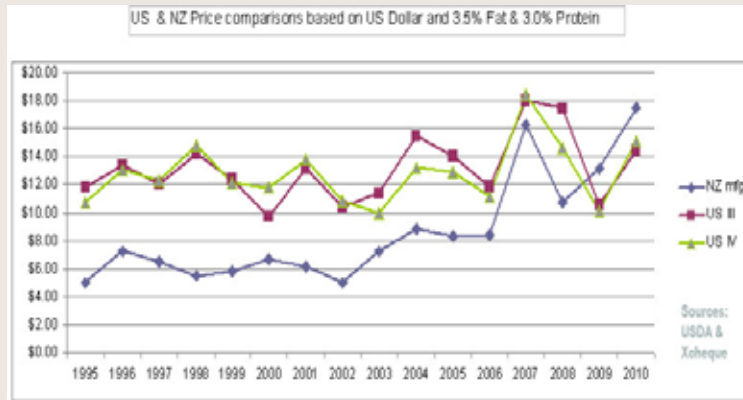
"Debating what is the best choice really has to begin with agreeing on what the problem is."

Andrew M. Novakovic, Ph.D.
EV Baker Professor of Agricultural Economics
August 2011 paper

Can we compete at the world price?

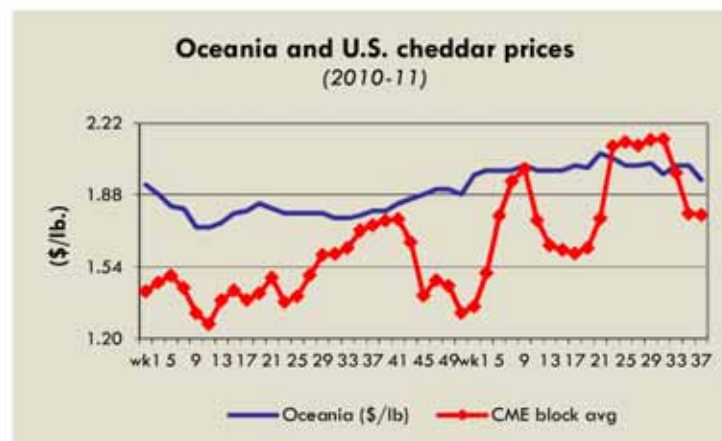
You bet!

NZ vs. U.S. Class III & Class IV



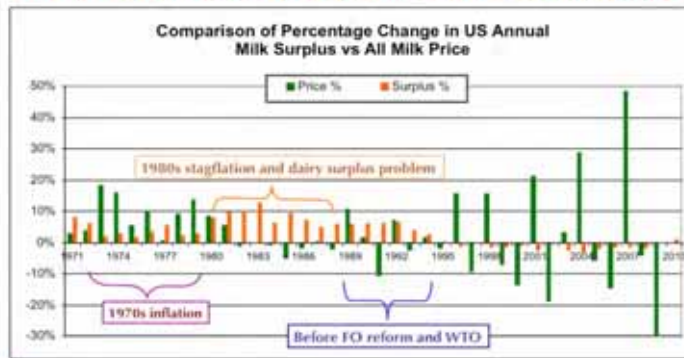
The problem in 2009 was not the fluctuation of prices, but how long the price flat-lined at such a low level even though Oceania prices turned around. WORLD DAIRY DEMAND GREW 1.5%

Volatility?! World? Or U.S.?



Do we have an over supply problem?

Is Milk Price Volatility Caused by Excess Production or Fluctuations in Demand or?



Cornell University
Department of Applied Economics and Management

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Cow vs. People:

Do we have an over supply problem?



-- 3 billion lbs
Monthly
Deficit

In Eastern/Central Time Zones!

- Mountain/Pacific Time Zones = 1.6 bil. lbs monthly surplus
- Add the unregulated milk and U.S. still has 200 mil lbs Monthly deficit.



Do we have an over supply problem?



Are supply management and tougher tariffs the answer?

Our horse is out of the barn... we will not get tariffs.

Farmers are realizing...

Best defense is good offense.

Look at corn & soybean / beef & pork!

▪ ***Market-Market-Market***

- Build long term customer relationships
- Be consistent supplier in the world market
- Compete for your market here at home!
- ***Innovate – Commodity vs. Value-Add***

Your backyard:
Northeast needs more milk!
(and it's not just Chobani!)

DMS Milk Marketing Statistics May 2011

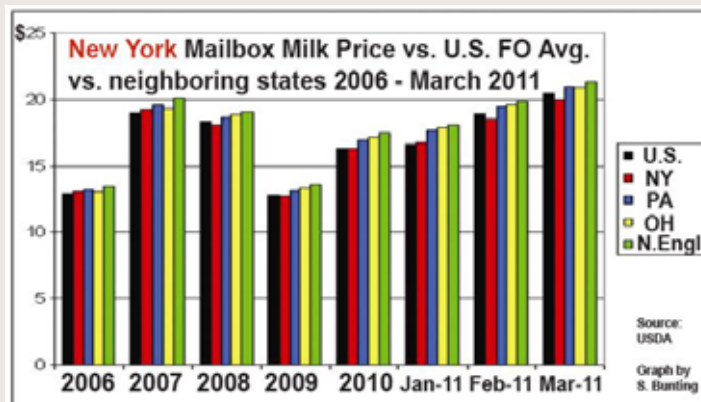
Producers reported for 367 days	% Change from April 2011	% Change from Mar 2011
DMS Milk Marketed	- 0.46	- 2.21
Total NY, PA and VT Milk Produced	- 0.58	- 1.04
Total US Milk Produced	- 0.28	1.10

Source: The Friday Facts June 17, 2011 Vol. 16 / No. 23

Chobani getting 57 loads a day; wants to be at 100 in 6 mos. – not getting what they need now... Producers being asked to increase 10%..... BUT...



NY Mailbox price is baffling



Summer no better... June-July-August NY 30 cents below national avg. (Distribution problem?)

Key question for U.S. dairy...

*Will the U.S.
continue to be
the balancer of the world supply
or a leader in supplying the world?*



Read, Learn, Speak Up

- Milk is your product, get involved in how it is marketed to your consumers
- Pricing system is broken
 - Need more transparency, more products reported and more plants reporting
 - More of retail \$ back to farmer
 - **Get involved**
 - **IT IS YOUR DAIRY FARM**