

Addressing Milk Price Volatility

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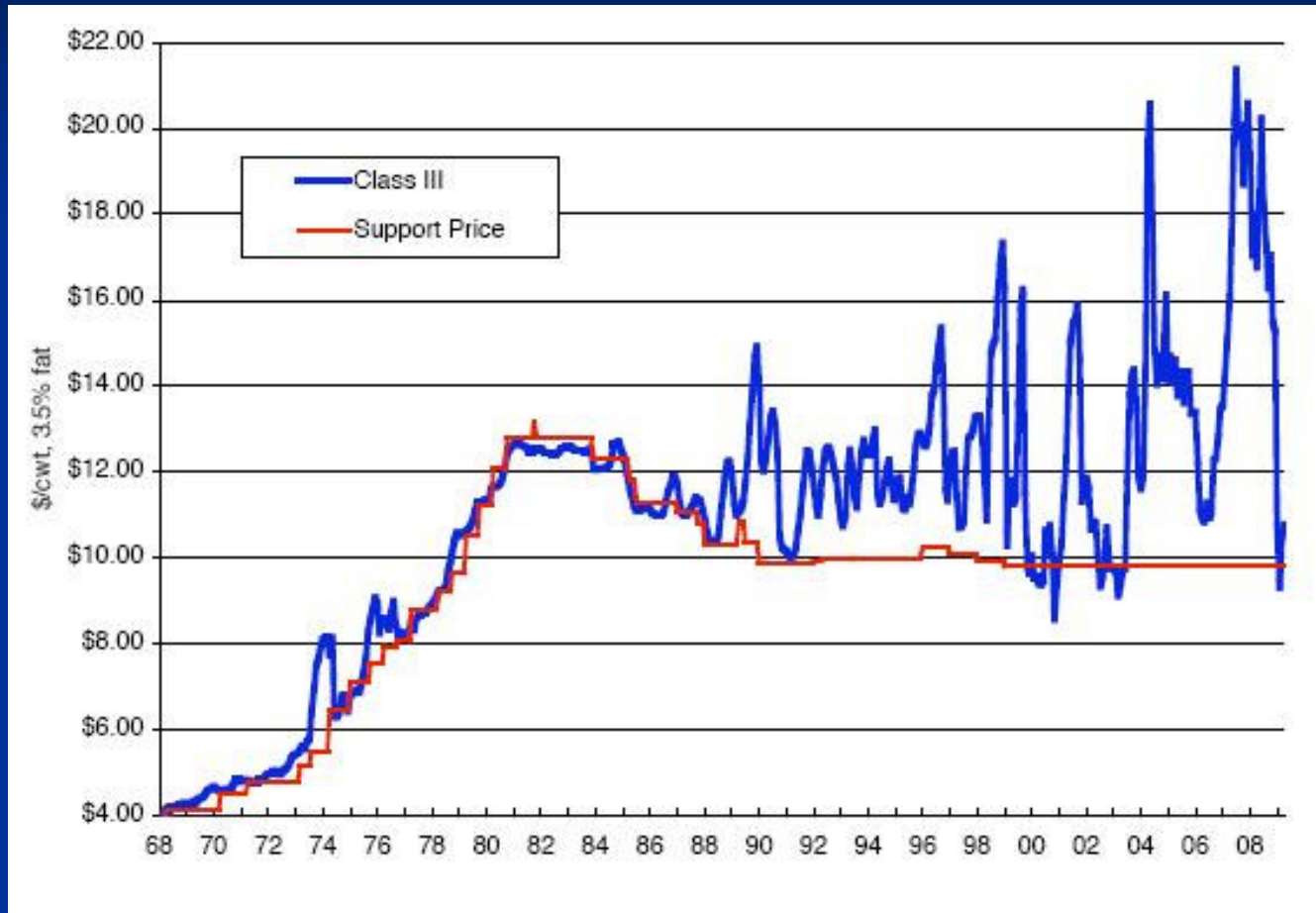
Why Do We Have Volatility?

- In short:

Given improvements in our operations, our feeding practices, and the genetics of our cows, the U.S. dairy industry is capable of increasing production at a faster rate than the market can absorb.

At the same time, every individual dairy has the incentive to get as much milk into their tank as possible.

Volatility is Not New

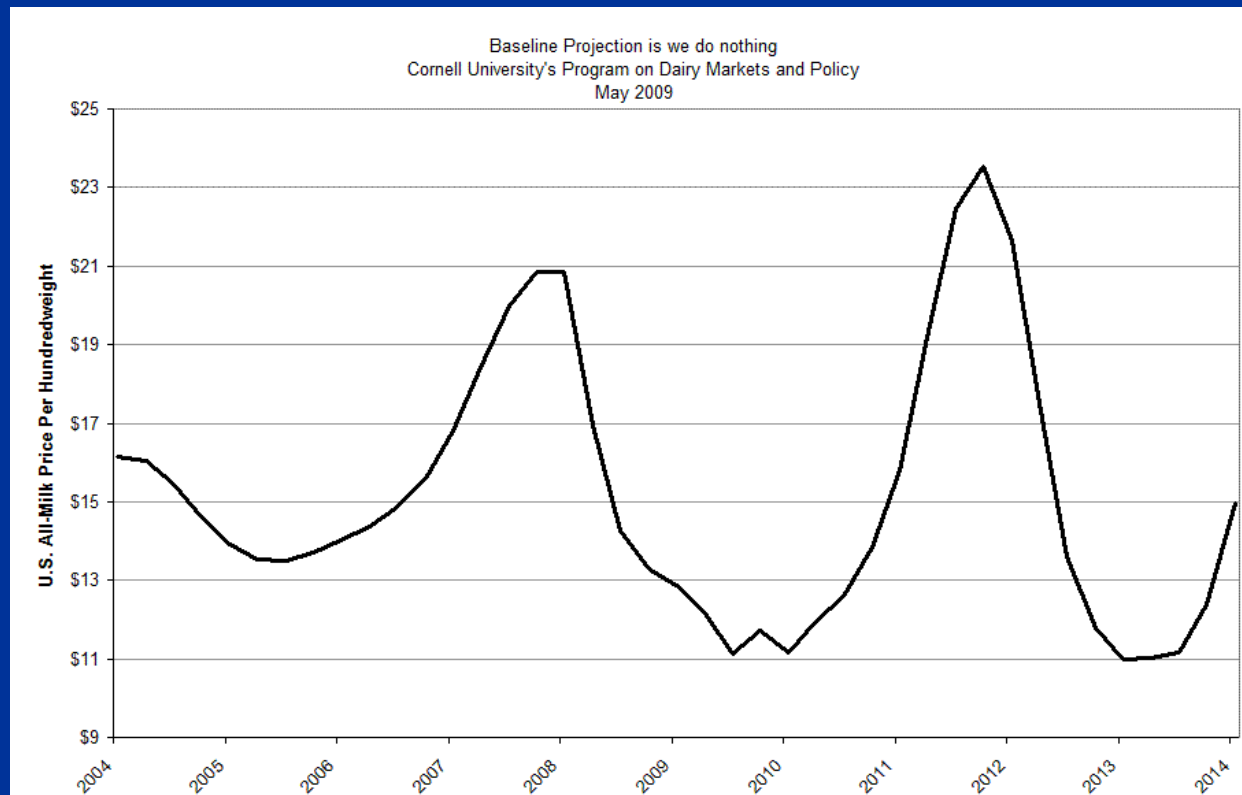


Courtesy of CPDMP, May 2009

But each cycle gets worse...

No Reason This Will Change On Its Own

According to economic model created by Cornell University's Program on Dairy Markets and Policy (CPDMP), this is what the next five years could look like.



What does this mean?

- This year is shaping up to be the worst year ever experienced by those currently in the dairy business.
- This year , dairy farmers are collective taking billions of dollars in equity built up over the decades they've been in business, and converting that equity into bank loans.

What does this mean? (cont.)

- There will be some producers that decide to get out of the industry – either by choice or by force. That is already going on.
- While that is extremely unfortunate, the real question I'd ask is for those who are staying in: With the massive boom/bust cycles that have become common in this industry, how do you plan to build your equity back up? And with the banks feeling the pain in this wreck, are they going to be there for you the next time to get you through that wreck?

It doesn't have to be like this.

Growth Management Plan

First, what the GMP is NOT:

- This is not a supply management program.
- Some critics will try to compare this to Canadian-style supply management, but that would be an inappropriate comparison. This program creates no significant barrier to growth. It merely creates a modest incentive for dairies to grow more strategically.

Growth Management Plan

What the GMP is:

- The Growth Management Plan is a uniquely-American concept that creates a financial incentive for dairies to actually pay attention to the amount of milk you produce.
- Dairies that wish to expand will budget the very modest costs of this program and still grow, while dairies that are not in expansion mode will have a financial incentive to keep their production in line from year-to-year.
- This program is about incentives, not government control over production.

Growth Management Plan

- A quick summary:
- Two numbers would be announced:
 - An amount of “allowable growth” that an individual dairy can produce without any payment of a “market access fee”
 - A “market access fee” to be paid on a “per hundredweight” basis for any dairy that exceeds that “allowable growth” during that quarter (*that market access fee would apply to all the production on that facility, not just the new growth*)
 - All “market access fees” collected are distributed to the dairies that stayed at or below their “allowable growth”

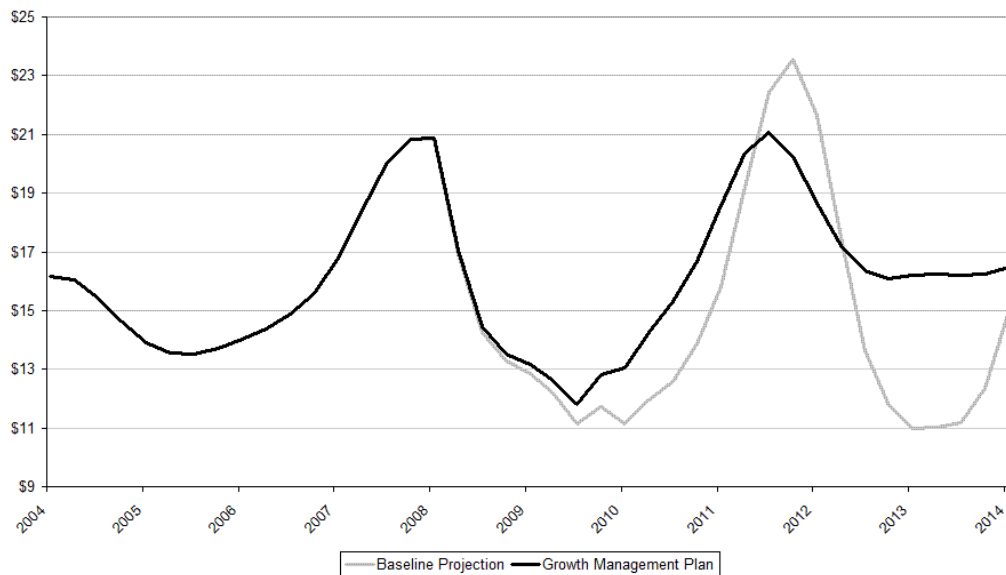
Growth Management Plan

Two-fold result:

- For dairies that wish to expand their production or start a new operation, they would budget for and pay a modest fee to access additional markets.
- For dairies that are not in expansion mode, the “refund” of the market access fees they would receive would provide a financial incentive to make sure they stayed within their allowable growth.

Growth Management Plan

Baseline Projection vs. Growth Management Plan
Cornell University's Program on Dairy Markets and Policy
May 2009



- This chart shows what Cornell University's model forecasts the U.S. all-milk price would be if we had the Growth Management Plan in place.
- Granted, we're in a hole that the Growth Management Plan can't get us out of overnight. But look at the next wreck predicted to be in 2012-2013. **Which line would you rather invest your hard-earned equity in?**

Growth Management Plan

- We work in a highly-regulated industry. Many of those regulations insulate the industry from real market signals.
- But contrary to what the critics may say, the GMP would actually get us CLOSER to real market signals on the dairies, not further away.

Growth Management Plan

How does this program get us closer to sending important market signals to the dairy farms?

- In virtually any other industry, a new entry into an established market would have to compete directly with its competition for a piece of that market. Usually, that new entry will have to compete by having a lower price or better quality to earn that market share. Once that market share is established, that new business merely needs to stay even with his competitors in order to maintain his customers.
- Contrast that with the dairy industry, where anyone can set up shop and as long as they can find a cooperative that will pick up their milk, they are guaranteed an equal share of the market revenues – **on day one**. What if the market is theoretically “full” and that new production is actually surplus milk that is ultimately sold to the government for \$9.90 per hundredweight? That cost is spread out over all producers in the pool while the new producer gets the full blend price, just like his neighbor.

Growth Management Plan

How would the GMP change that?

- Under the GMP, the new entry would still be able to set up a dairy just as they can now. But during the first year of production, that dairy would need to pay a “market access fee” – their cost for bringing new production to the market.
- That fee would be distributed to all the dairies that hold their production in check, which in turn allows the market room to absorb the additional production.

Growth Management Plan

“I want to grow – why would I support this plan?”

- The GMP is designed to create a financial incentive to pay attention to how much milk you are producing, but it's not designed to stop growth.
- You can budget for a \$0.50, \$0.75, \$1 per hundredweight “market access fee” for a year. How do you budget for a milk price that swings \$10 per hundredweight from year to year?

Dairy Price Stabilization Program

- Holstein Association USA has unveiled the “Dairy Price Stabilization Program”
- While some of the details differ from the Growth Management Plan, the concept is identical.
- Milk Producers Council is supporting the Holstein Association and assisting them in promoting this concept.

Closing Thoughts

- We already have a default “supply management” program in place (*i.e. enough dairy farmers go broke that the production eventually tapers off and supply reaches demand*).
- How viable is an industry that operates that way? How bankable is an industry like that?
- We have an opportunity to have a national debate about the future of this industry. We would be foolish to let this go by.

Questions?

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