The Challenges and Opportunities for U.S. Dairy Policy

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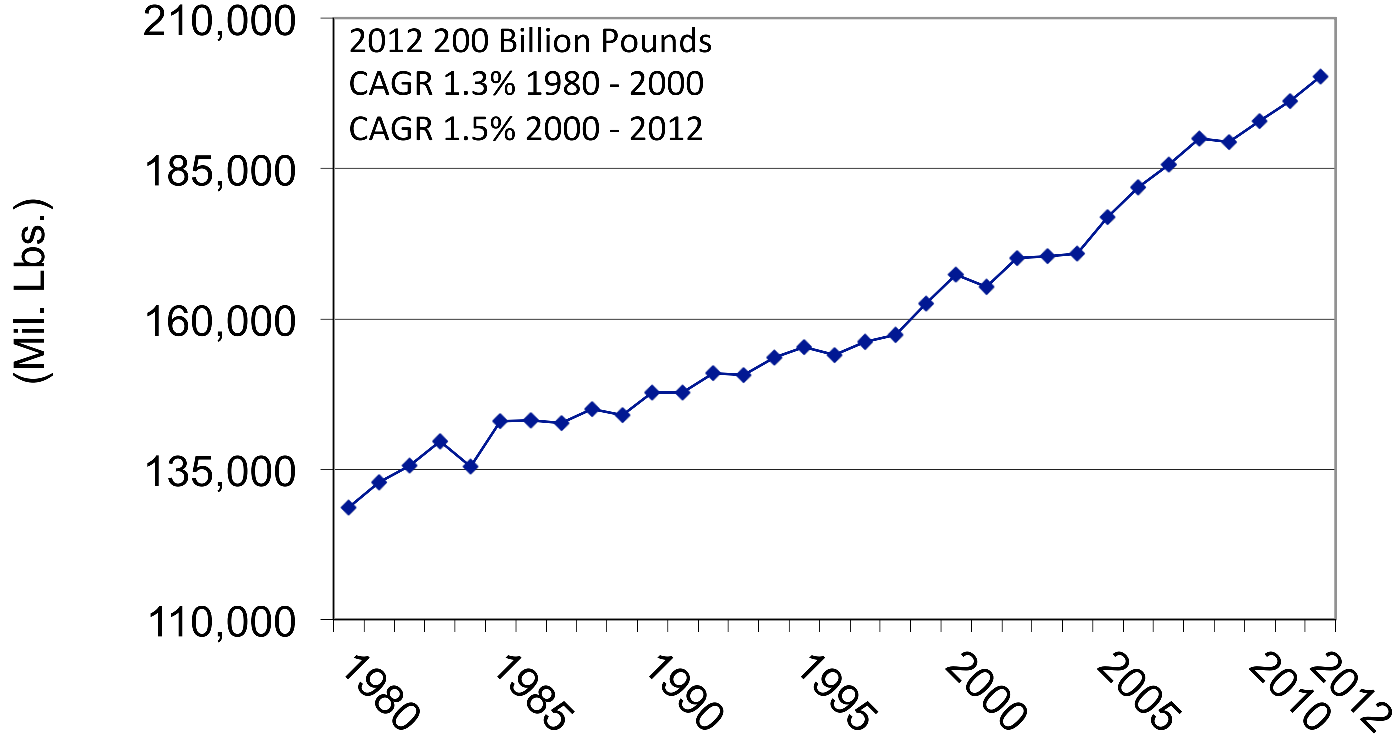
Setting the Stage

- Dairy Industry Trends
  - U.S. Milk Production
  - Dairy Demographics
  - Domestic vs. Export Dairy Demand
- Federal Dairy Policy
  - Federal Milk Marketing Orders
  - Support Price Program
  - MILC Program
- 2012 Farm Bill – Dairy Security Act

U.S. Milk Production



Source: USDA, NASS

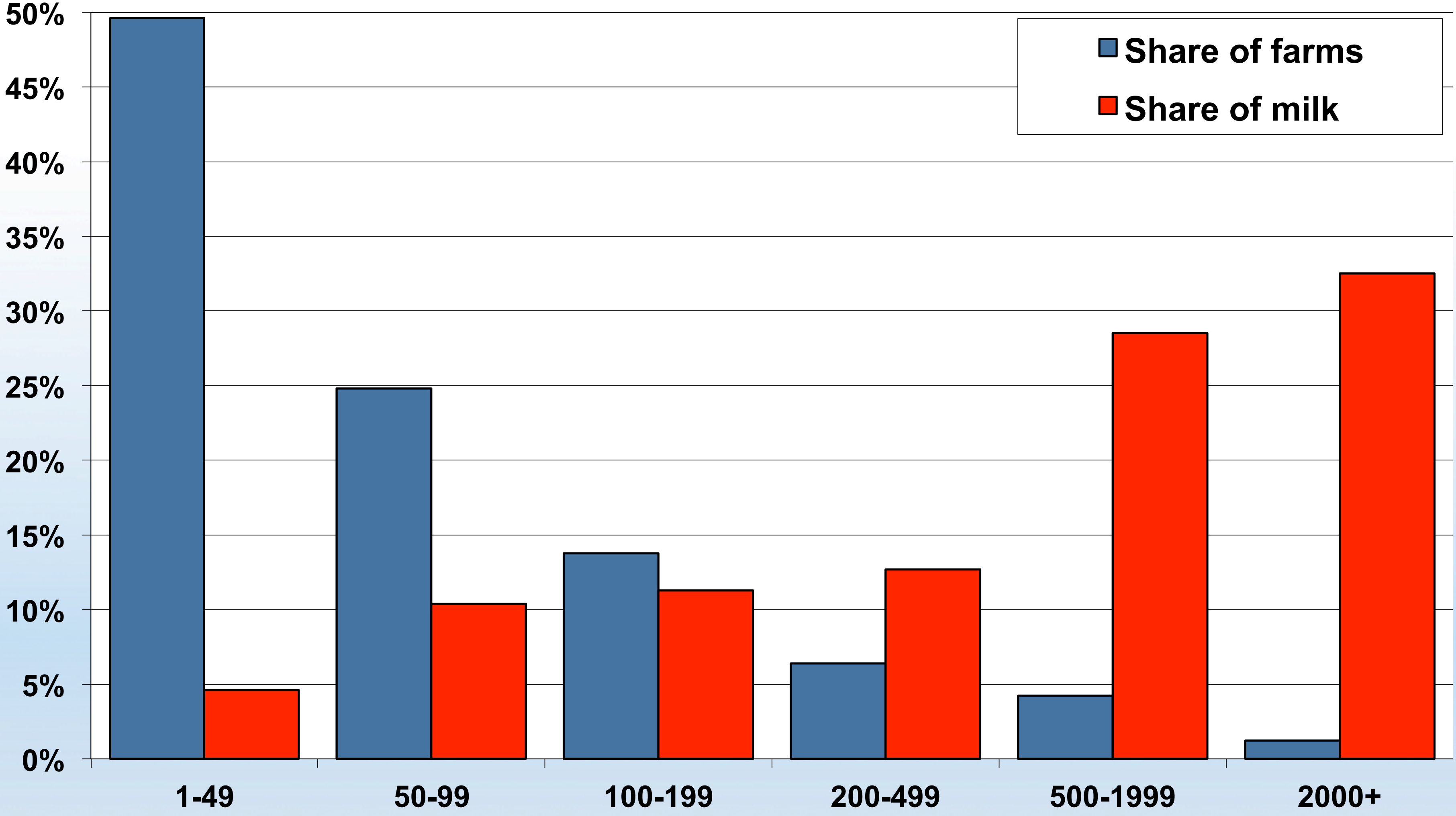
Dairy Demographics

Herd Size	# Farms 2000	# Farms 2005	# Farms 2011	% Percent 2011 vs. 05
1 – 99	84,220	60,510	44,300	-27%
100 – 499	18,175	14,717	12,300	-16%
500 – 999	1,700	1,700	1,650	-3%
1000 – 1999	690	850	950	+12%
2000+	270	523	800	+53%
Total	105,055	78,295	60,000	-23%

Source: USDA, NASS

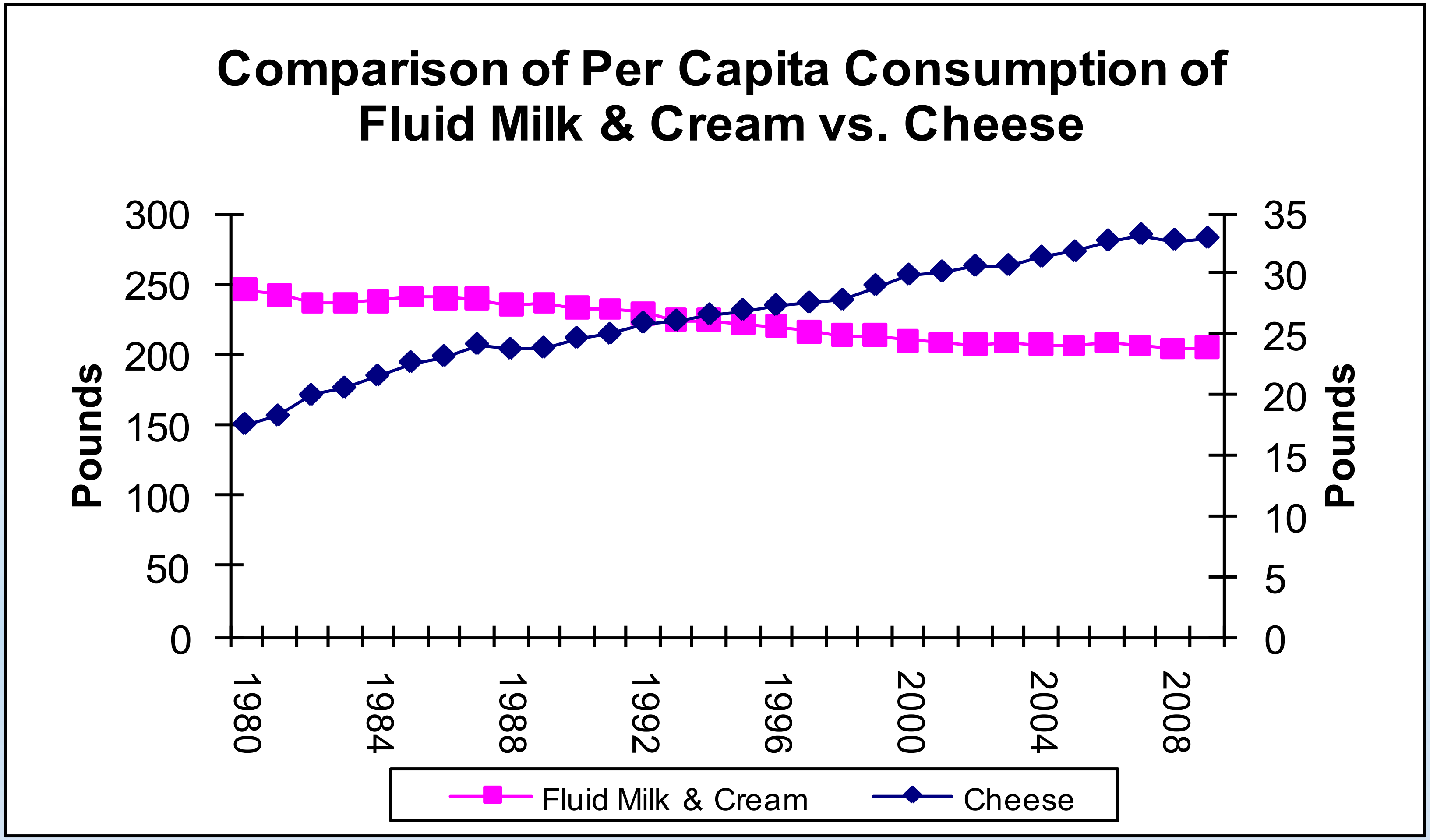
Dairy Demographics 2011

The 3,400 dairy farms with more than 500 cows account for more than 60% of U.S. milk production



Source: USDA, NASS

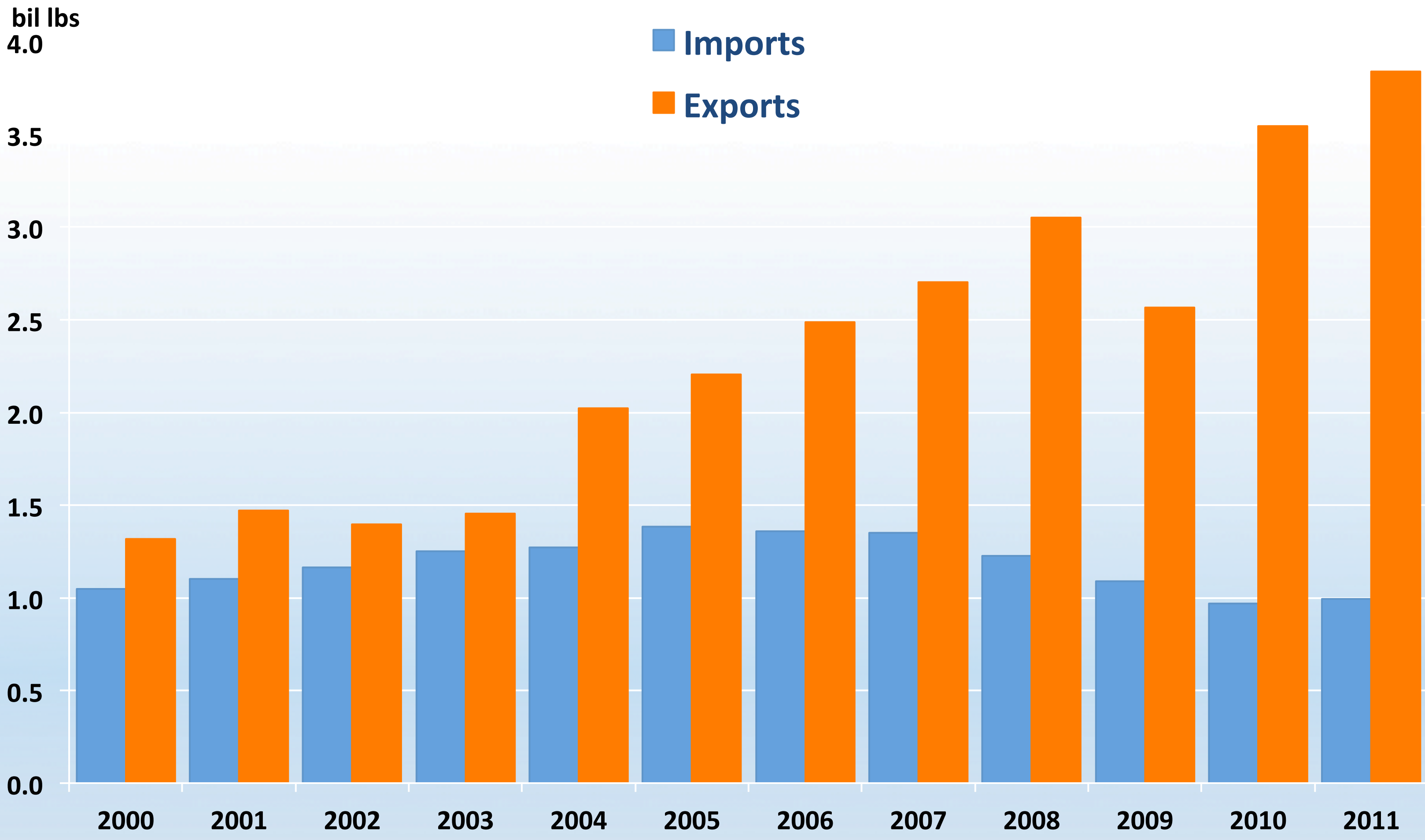
Per Capita Consumption



Source: USDA, ERS

U.S. Dairy Export Growth

U.S Dairy Exports have more than doubled during the past decade.



Source: USDA, FAS

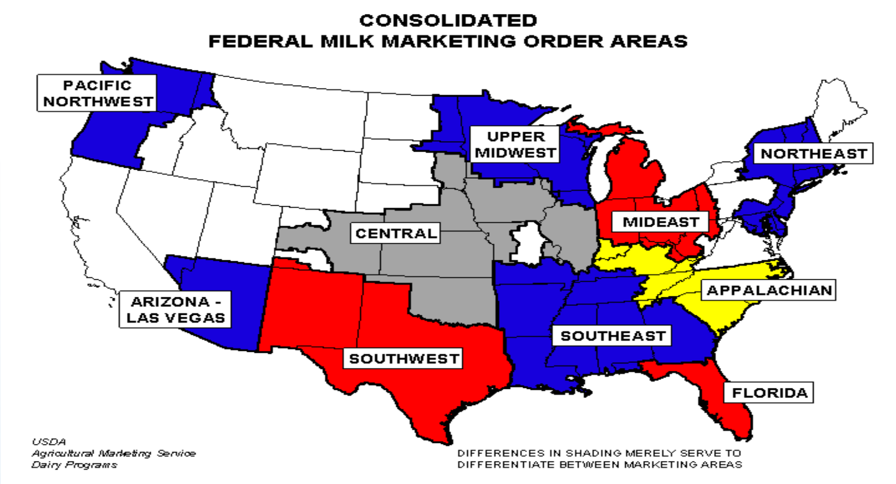
Dairy Trends Take Away

- U.S. dairy industry has the potential to grow.
- While larger dairy operations continue to produce a greater percent of U.S. milk production, commercial milk production occurs in all size categories.
- Per capita consumption of cheese and yogurt are the driving forces of domestic dairy product demand – not fluid milk at least not white milk as we know it.
- The growing global economies offer tremendous growth opportunities for the U.S. dairy sector.

Federal Dairy Policy

- Federal Milk Marketing Orders
- Dairy Product Price Support Price Program
- Milk Income Loss Contract Program
- Dairy Security Act

Federal Milk Marketing Orders



- Federal Milk Marketing Orders were set up in 1937 to establish:
  - "orderly" marketing conditions for inter-state commerce,
  - income parity for farmers,
  - and to increase bargaining power of farmers.
- Securing an adequate milk supply was also a policy consideration.
- At the time the vast majority of milk was converted into fluid milk products.
- Federal Orders "pool" farmers receipts. That is farmers receive the weighted average price for all the milk marketed in their Federal Order.
- Federal Orders audit processors to assure that producers are paid at least the regulated market-average prices.

Federal Order Classified Pricing

Processors pay for milk based upon use/classification

Class I Milk	Class II Milk	Class III Milk	Class IV Milk
$$$	$$	$$	$$
Fluid Milk	Yogurt, Ice Cream	Cheese, Whey	Butter, Nonfat Dry Milk Powder


Fluid Milk


Yogurt


Ice Cream


Cheese

Whey

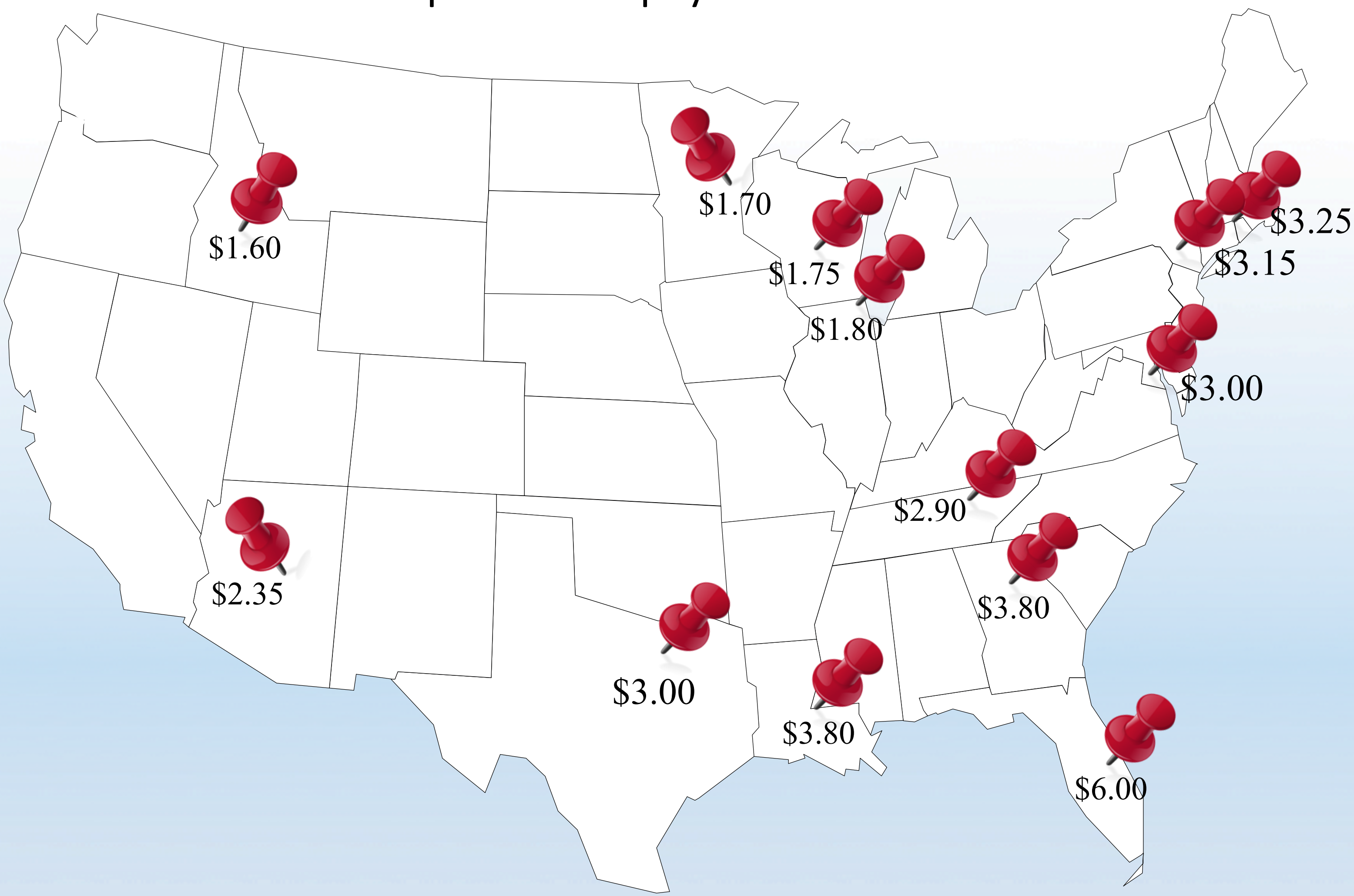

Butter


Nonfat Dry Milk Powder

Milk Producers are paid the weighted average price based upon how milk is utilized in their order.

Federal Order Class I Differentials

In addition to the Class I milk price, fluid milk processors pay a Class I Differential



Upper Midwest Class Prices: December 2012

- Class I **(announced November 21, 2012**)
  - Adv. Class III price = $21.39
  - Adv. Class IV Price = $18.82
  - Chicago Class I Differential = $1.80
  - Chicago Class I Price: ($21.39 + $1.80) = $23.19

- Class II Price: $18.30 **(announced January 3, 2013)**
- Class III Price: $18.66 **(announced January 3, 2013)**
- Class IV Price: $17.83 **(announced January 3, 2013**)

The weighted average of these prices were paid to farmers by January 18, 2013

Estimated Upper Midwest: Producer Blend Price

	Percent Utilization	Class Price	Blend Impact
Class I	11%	$23.19	$2.55
Class II	6%	$18.30	$1.10
Class III	78%	$18.66	$14.55
Class IV	5%	$17.83	$0.89
Blend Price			$19.09

Southeast Class Prices: December 2012

- Class I **(announced November 21, 2012)**
  - Adv. Class III price = $21.39
  - Adv. Class IV Price = $18.82
  - Atlanta Class I Differential = $3.80
  - Atlanta Class I Price: ($21.39 + $3.80) = $25.19/cwt.

- Class II Price: $18.30 (announced January 3, 2013)
- Class III Price: $18.66 (announced January 3, 2013)
- Class IV Price: $17.83 (announced January 3, 2013)

The weighted average of these prices were paid to farmers by January 18, 2013

Estimated Southeast: Producer Blend Price

	Percent Utilization	Class Price	Blend Impact
Class I	63%	$25.19	$15.87
Class II	9%	$18.30	$1.65
Class III	19%	$18.66	$3.55
Class IV	9%	$17.83	$1.60
Blend Price			$22.67

Challenges in Federal Order Milk Pricing

- Regional differences in the regulated milk prices received by dairy producers and differences in the class prices paid by dairy processors have contributed to the lack of consensus building and cohesive dairy policy in the industry.
- The lag in milk prices distort market signals to dairy producers and contribute to price volatility.
- Changes in Federal Orders are difficult to come by.

No Separation of Power…

- USDA serves as the gatekeeper and determines what proposals to change the Federal Orders are deemed worthy of a hearing.
- USDA serves as the jury and listens to industry participants views on the proposals.
- USDA issues its recommendation.
- The industry comments on this recommendation.
- USDA issues its final rule.
- Historically, this process takes about 2 years or longer. The 2008 Farm Bill streamlined this process to about 13 months, but it has yet to be tested.

As long as you sleep under my roof, you live by the rules of my house…

- Dairy farmers are offered the opportunity to accept USDA's final rule or the Federal Order is voted-out.
- Cooperatives bloc-vote for their producers, so it's tough for individual producers to have a voice.
- The threat of not having a Federal Order has historically resulted in dairy producers/cooperatives accepting USDA's final rule.
- Significant change is difficult to achieve from system in which the gatekeeper, jury, and enforcers are employed by the system.

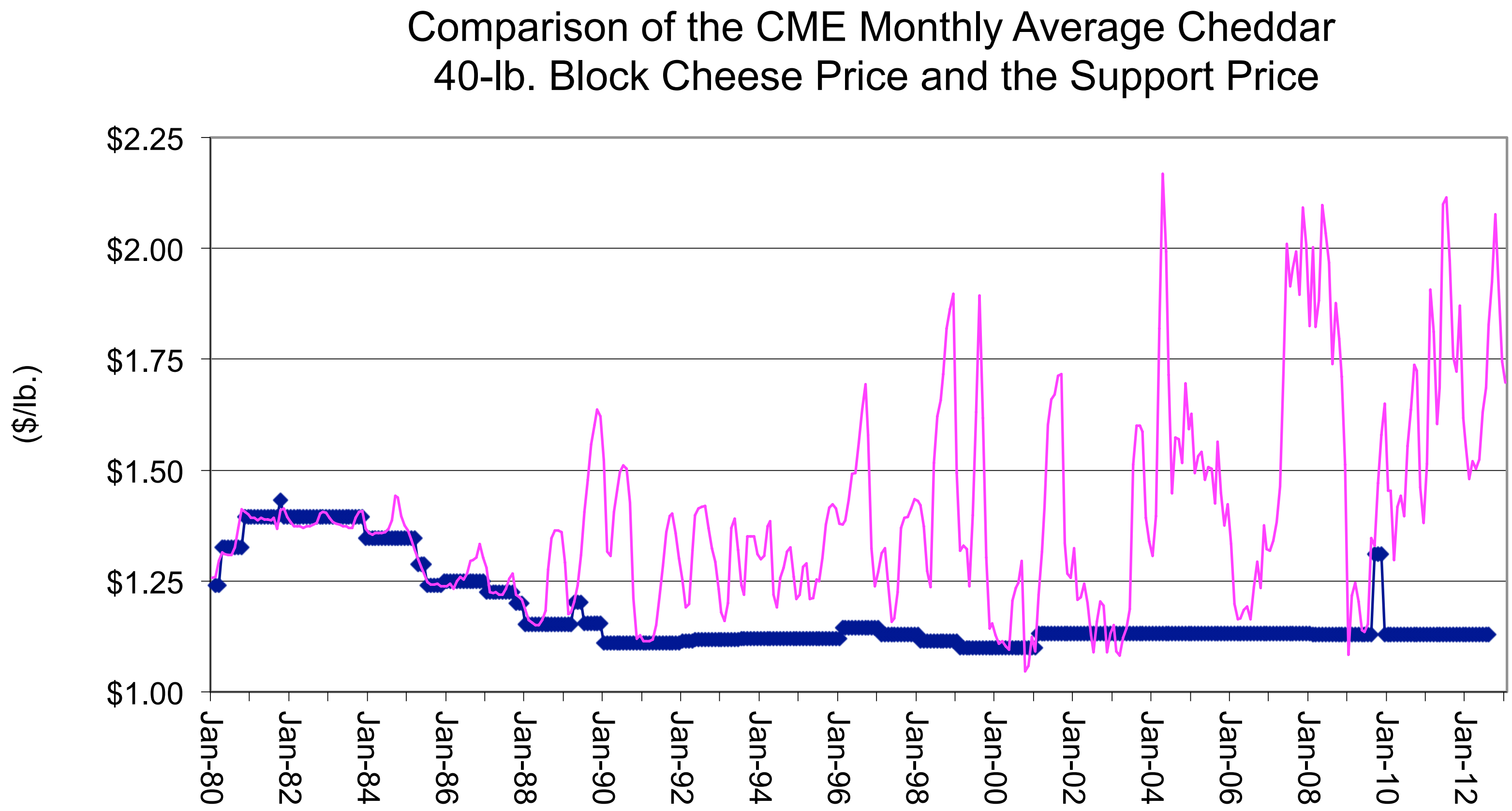
The Opportunity for Federal Orders

- Transparent market information is key to providing an equal playing field for dairy farmers, cooperatives, proprietary firms, end-users and consumers.
- Both producer and processor groups have discussed reducing the number of class prices.
- The continual decline in fluid milk sales would suggest that the industry's ability to "milk" the class I market is limited.
- The opportunity for Federal Orders is to define today's public policy issues and to provide solutions:
  - Obesity
  - Price Volatility
  - Global Competitiveness
  - Simplification

Dairy Product Price Support Program

- The dairy product price support program is an indirect safety net for milk prices through a standing government offer to buy storable dairy products (specifically cheddar block and barrel cheese, nonfat dry milk, and butter) at a pre-announced price known as the support price.
- Offering product to the government under the support price program is voluntary. In other words, spot markets can (and have) fallen below the dairy product support prices.
- The program has rarely been used during the past five years because market prices have exceed the support prices.

Cheddar Block Support Price



Source: USDA, ERS

Dairy Product Price Support Program

- This is also the program grabbed national headlines at year-end.
- Reverting to 1949 legislation had the potential to raise the current dairy product support prices four-fold.
- BUT milk prices would not have doubled in January if we fell off the dairy cliff because the dairy product support prices do not set the Federal Order milk prices.
- Eventually prices for dairy products purchased under the support program would have been included in USDA's weekly dairy product prices survey and would have influenced commercial milk and dairy product prices.
- But, it got a lot of people inside and outside the beltway talking about milk prices and dairy policy.
- Both processor and producer groups agree that the support price program needs to be eliminated to enhance the competitiveness of U.S. dairy exports.

Milk Income Loss Contract (MILC)

- The MILC program evolved from the Northeast Dairy Compact and was nationalized in the 2002 Farm Bill, and provides a safety net on the first 2.985 million pounds of milk a dairy operation produces.
  - That's equal to the annual production from the average 150-cow dairy farm but only 3-weeks of production from the typical 2,000-cow dairy farm
- The inability of the MILC program to provide a basic safety net for producers of all sizes led the National Milk Producers Federation to create the Dairy Security Act.

Dairy Security Act

The elimination of the price support program and MILC program provide the majority of the funding for the Dairy Security Act.

Dairy Producer Margin Protection

- Provides margin protection by paying the difference between the All Milk Price and national average feed costs when margin falls below $4/cwt.
- Participation in the margin program is voluntary, and enrollment is for the life of program.
- Supplemental coverage is also available at a cost to producers to cover margins between $4 and $8/cwt .

Dairy Market Stabilization Program

- Only producers participating in the Dairy Producers Margin Protection Program are automatically enrolled in this program.
- Requires producers to choose whether to reduce marketings between 2 and 8 percent from their DMSP base production OR having their milk checks reduced by between 2 and 8 percent OR some combination of the two.

It is these two proposed programs that divide much of the industry, the House and the Senate and my co-panelists may discuss this program in more detail.