



Insights on today's global dairy business from the Hoogwegt companies

**MARKET MATTERS**

**U.S. Debates Supply Management**

Just as the European Union looks to wind down its supply management system, the United States is considering moving toward a program of its own to try to curtail milk price volatility. Over the past year, three possible plans have surfaced, but implementation is far from certain.

All three programs would replace the government's Dairy Product Price Support Program, which provides a farm price floor at \$9.90/cwt., and the Milk Income Loss Contract (MILC) program, which pays producers a subsidy when the Boston Federal Milk Marketing Order Class I price for fluid milk falls below \$16.94/cwt.

**Plan I: Foundation for the Future**

The National Milk Producers Federation (NMPF), the largest producer trade group in the United States, has designed a comprehensive plan to reform dairy pricing called the Foundation for the Future.

The first part of the plan, the Dairy Producer Margin Protection Program, acts as an insurance program by protecting producers from catastrophic losses due to low margins. Producers who want protection above a certain level pay a premium. When margins fall below a certain predetermined point, taxpayer money and funds from producer premiums would be used to make up the difference on 90% of a producer's milk.

| Government Outlays Under Dairy Producer Margin Protection Program (billions of dollars) |      |      |      |      |      |      |
|---|------|------|------|------|------|------|
| 2014  | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
| 1.98  | 0.03 | 0.12 | 0.06 | 0.05 | 0.02 | 0.02 |

*Source: Food and Agricultural Research Institute.*

The second part of NMPF's plan, the Dairy Market Stabilization Program, is designed to prevent an oversupply of milk. When the feed-milk price margin dips below a certain level, USDA would notify producers that supply is out of balance with demand and that they will only receive payment on a percentage of their base marketings (determined by the average of the most recent three-months milk production or the same month a year earlier) until

supply comes back into balance with demand.

**Plan II: Costa-Sanders**

Companion bills (H.R. 5288 Dairy Price Stabilization Program Act of 2010 and S.3531 Dairy Market Stabilization Act of 2010) were introduced in the U.S. house and Senate last year, but neither made it to a vote. However, these bills could be reintroduced as an alternative to the other plans.

Under these programs, individual dairies could choose to maintain their current production levels, along with an allowable year-over-year growth rate based on market indications, or expand production. Those who choose to expand would pay a fee that in turn would be paid out to producers who maintain output.

**Plan III: Marginal Milk Pricing Program**

Under the third program, devised by Agri-Mark dairy cooperative, producers who continue to produce milk above a predetermined base level would pay a penalty equivalent to the cheese milk price (Class III) whenever prices fall below a pre-designated level. The revenue generated from these penalties would be used to purchase cheese, which in turn would be donated to charitable food programs.

A producer's base level would be calculated using a farm's milk production level in any three consecutive months during the previous year. When farm prices return to pre-determined levels that provide an adequate price, the program would cease to operate.

Opposition to these plans remains strong. Some dairy producers and the International Dairy Foods Association, the largest processor trade group in the United States, remain opposed to any type of supply management. Yet despite this opposition, producer groups appear ready to push hard for some type of new safety net that includes a supply management component when the next farm bill, slated for 2012, comes up for debate.

The U.S. dairy industry has a long, unsuccessful history with supply management plans but quite remarkably these plans, particularly Foundation for the Future, continue to gain momentum.

## HOOGWEGT FORECAST

|            | U.S. Average Prices |       |        | EU Average Prices |       |        | Oceania Average Prices |       |        |
|------------|---------------------|-------|--------|-------------------|-------|--------|------------------------|-------|--------|
|            | \$/ton              | \$/lb | Trend  | \$/ton            | \$/lb | Trend  | \$/ton                 | \$/lb | Trend  |
| SMP        | 3.630               | 1,65  | Weak   | 3.550             | 1,61  | Firm   | 3.450                  | 1,56  | Stable |
| FCMP / WMP | 4.400               | 2,00  | Stable | 4.400             | 2,00  | Stable | 4.200                  | 1,91  | Stable |
| Butter     | 4.625               | 2,10  | Stable | 5.550             | 2,52  | Stable | 5.250                  | 2,38  | Stable |
| Cheddar    | 3.630               | 1,65  | Stable | 4.700             | 2,13  | Weak   | 4.450                  | 2,02  | Stable |
| SWP        | 1.325               | 0,60  | Stable | 1.375             | 0,62  | Stable |                        |       |        |
| Lactose    | 1.000               | 0,45  | Firm   | 1.350             | 0,61  | Stable |                        |       |        |

U.S. prices stated ex-works / incl. expected CWT subsidy where applicable; world prices stated FOB main port; EUR/USD: this week 1,44

## WORLD COMMENT

Last week dairy markets were again quite active in most regions of the world. In the European Union the market for skim milk powder (SMP) firmed again driven by strong sales. Assisted by a weakening USD, EU prices are closing the gap with the fairly stable prices from the USA, an origin which has been rather absent from the export markets. Proteins are still tight in the USA. The full cream milk powder (FCMP) market has been extraordinarily volatile in the past month: New Zealand tender prices moved up and down over 10% in both directions. EU and South-American FCMP prices moved steadily lower, more or less reconnecting with Oceanic levels. The Southern hemisphere has entered the low production season; spot offerings are down considerably. The EU cheese market reached a ceiling; resistance against the higher prices seemed to have gained momentum. Butter and AMF continue to trade at the rather high prices, even with export demand being weak. NZ is still leading the AMF market. Whey powder in the EU, volatile as usual, is moving up again at still exportable prices. US whey is only slowly reacting to the loss of market share in the Far East.

## BRINGING IT HOME

## Impact studies differ substantially

Without industry consensus, something that has been nearly impossible to achieve in the United States, supply management will be difficult to implement. In February *Dairy Herd Management's* weekly web newsletter polled its readers and found that 44% opposed NMPF's Foundation for the Future, while 24% favored it. The International Dairy Foods Association also opposes any plan that would reduce milk output. However, it is still worth exploring potential impacts of the various options.

A comprehensive study by researchers at Cornell University and the University of Wisconsin shows that all three plans would significantly reduce government expenditures for dairy programs. The Marginal Milk Pricing Program would cut government costs most dramatically (\$3.2 billion over the 2010-18 study period), followed by NMPF's Foundation for the Future at \$1.6 billion and the Costa-Sanders plans at \$1.1 billion.

This analysis also shows that cumulative milk production over the study period would decrease between 0.4% and 0.7% under the producer plans but increase by as much as 0.8% under the Costa-Sanders bills. Milk prices to producers would increase between 17 and 23 cents per hundredweight under the two producer plans but not under Costa-Sanders. Dairy exports, mostly cheese and

whey, would also decrease under the producer plans as milk production declines, but exports would increase under the Costa-Sanders bills.

Another analysis by the Food and Agricultural Policy and Research Institute (FAPRI) concludes that NMPF's Foundation for the Future would have little impact on dairy markets, yet would help keep year-over-year increases in milk production to a minimum by providing incentives to producers to cut back on production to correct looming surpluses.

A third study by Informa Economics shows that while NMPF's Dairy Market Stabilization Program would not significantly curtail excess milk production, it would have reduced producer income by \$626 million over the 2000-09 study period, with more than half of the losses occurring in just five states. NMPF, however, disputes this study.

Unlike during the 1980s, when the U.S. government was carrying burdensome stock levels, today's supply management programs are focused on price volatility and designed to prevent low prices. However, the European Union has had supply management since 1984 and it has not eliminated price volatility.

## Did you know?

- *EU Common Agricultural Policy reforms, which decreased product volume on world markets, and drought in Oceania, sent prices to record highs in 2008, but when demand fell and prices crashed, calls for supply management were triggered in the United States.*
- *Due to enormous stocks of dairy products, the U.S. government in the early 1980s made direct payments of \$10/cwt. for 15 months to U.S. producers who reduced milk marketings by 5% to 30% below their base.*
- *Currently, the CWT herd retirement program removes U.S. milk herds from the market in an effort to curtail supply.*

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