Dairy Price Stabilization Program

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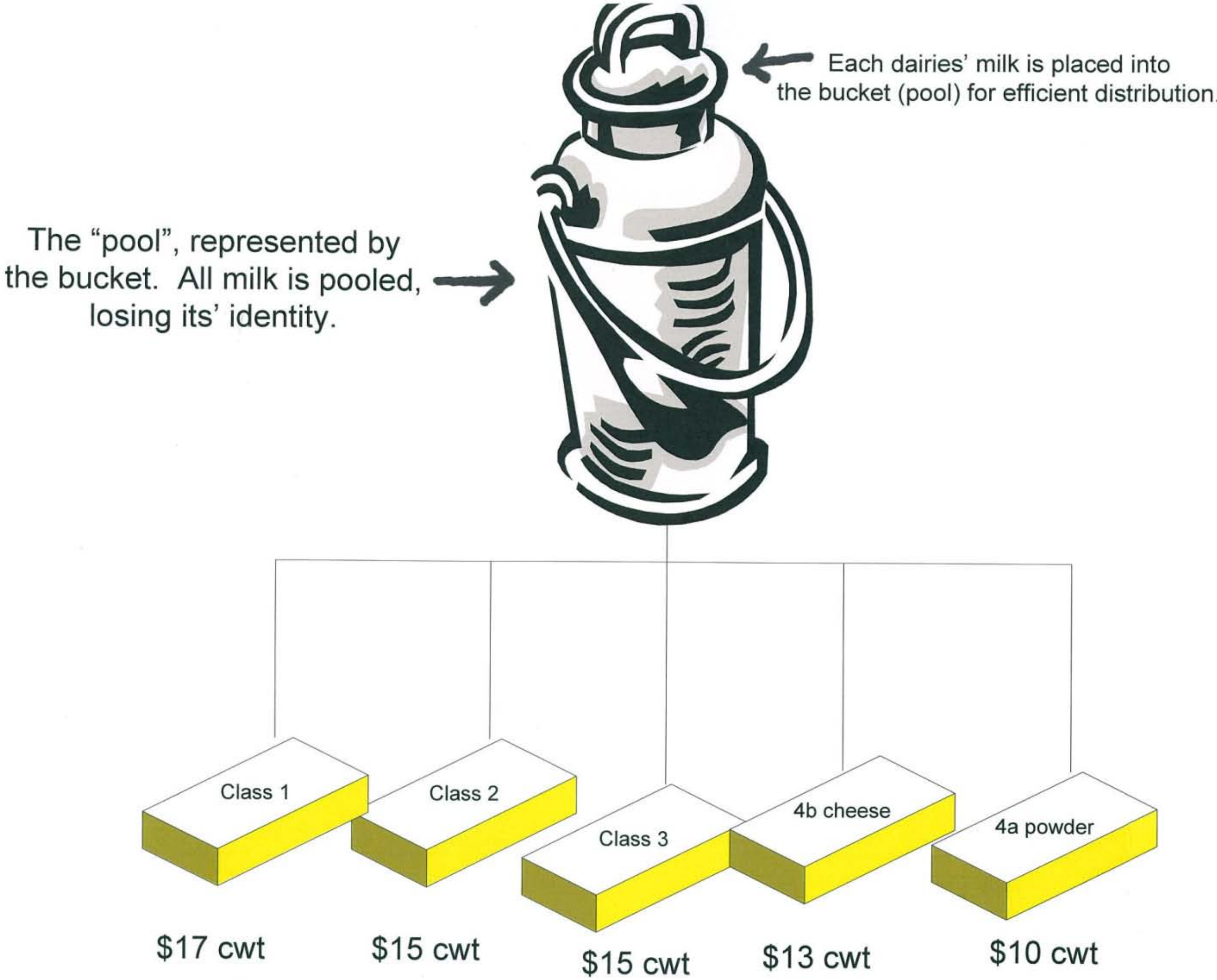
First, Let's Look at the U.S. Dairy Industry

1982	307,920 dairies
Today	65,000 dairies

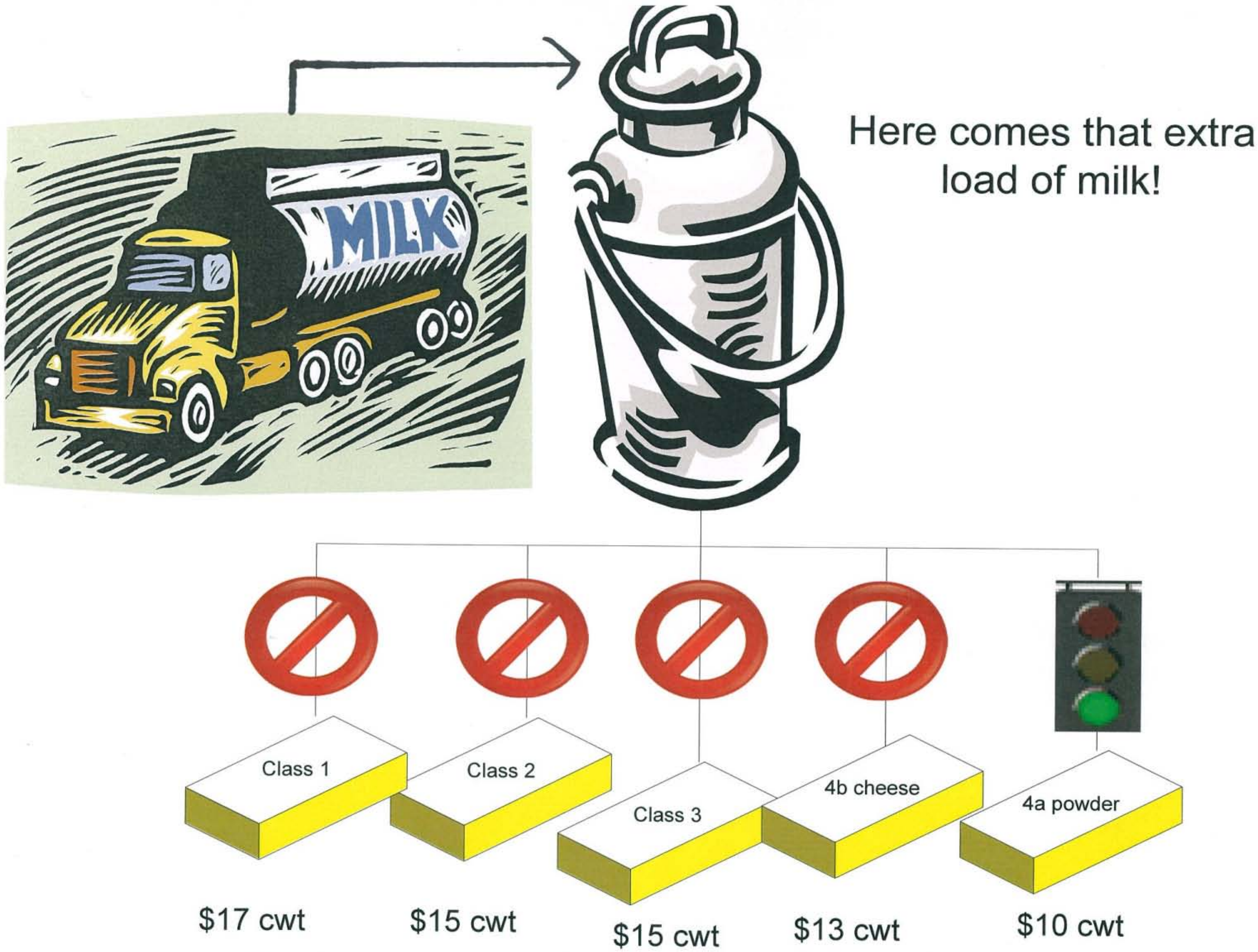
- Almost an 80 percent reduction in 27 years
- Average loss of 173 dairy operation per week

Understanding Pooling



All values are averaged by usage to establish the **blend price**.

Understanding Pooling



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Understanding Pooling

- All extra milk must, by definition, flow to the lowest value, in that the higher valued product demand is satisfied.
  - So, that extra tanker of milk presents to the pool a $10 cwt value, but the producer will receive the blend price ($15 cwt?)
  - That loss of $5 cwt is **borne by all producers in the pool**.
- The coops simply do not have any incentive to resist that overproduction because:
  - Producers demand of their coops to take all the milk they wish to produce.
  - Manufacturing cooperatives make money on the Make Allowance.
  - When the blend price goes down, it affects only producers, not coops.
- **It makes sense for producers to produce all they want, all the time**, regardless of demand, because the price decline caused by overproduction is imputed to all producers.
  - So those who do not grow are unfairly affected.

Dairy Price Stabilization Program

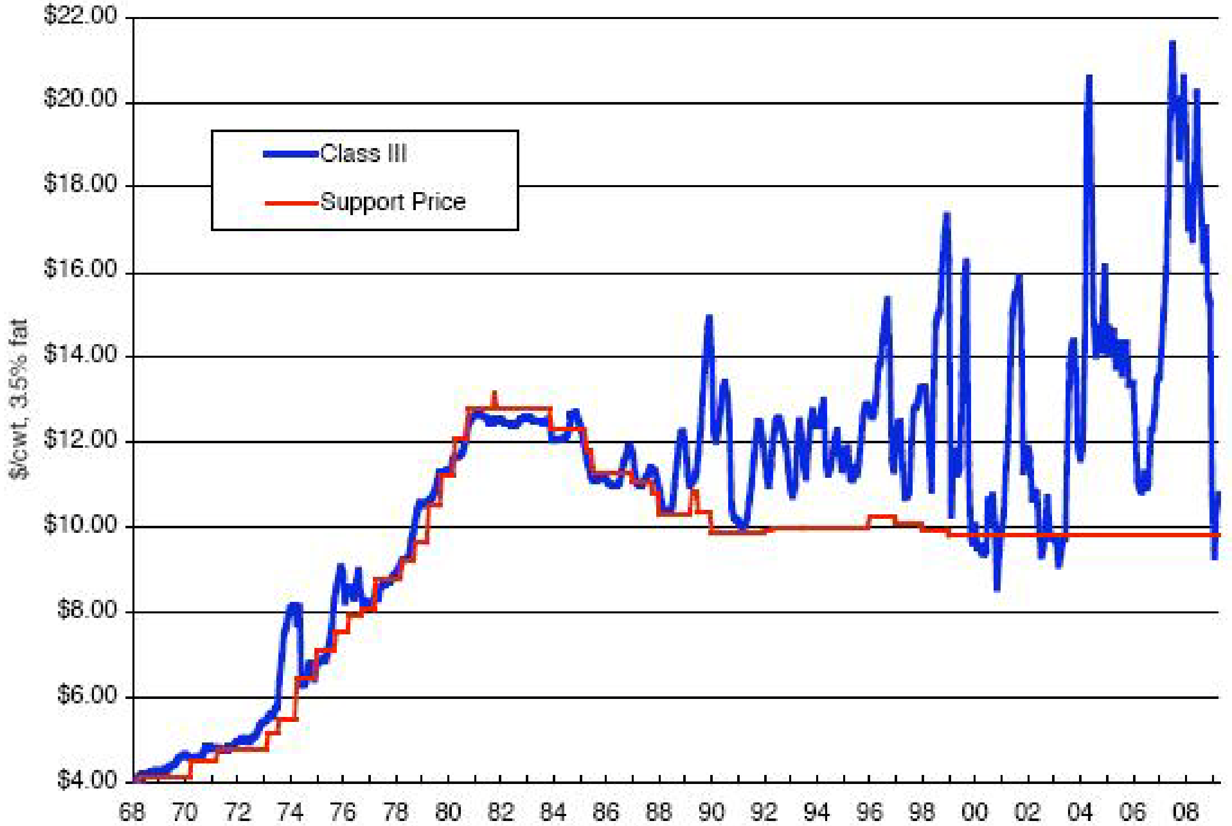
- The Dairy Industry Advisory Committee was established to review issues impacting **Milk Price Volatility** and **Dairy Farmer Profitability**.

- These are related, but different, issues.

- Between the “peaks” and “valleys” of our milk price, we have long-term profitability. If we didn’t no one would ever own a dairy farm. But the “valleys” are getting so deep and financially devastating that otherwise-healthy dairies cannot survive.

- The Dairy Price Stabilization Program is a legislative proposal that would fundamentally address the root-cause of milk price volatility – **the lack of any incentive to manage milk production growth**.

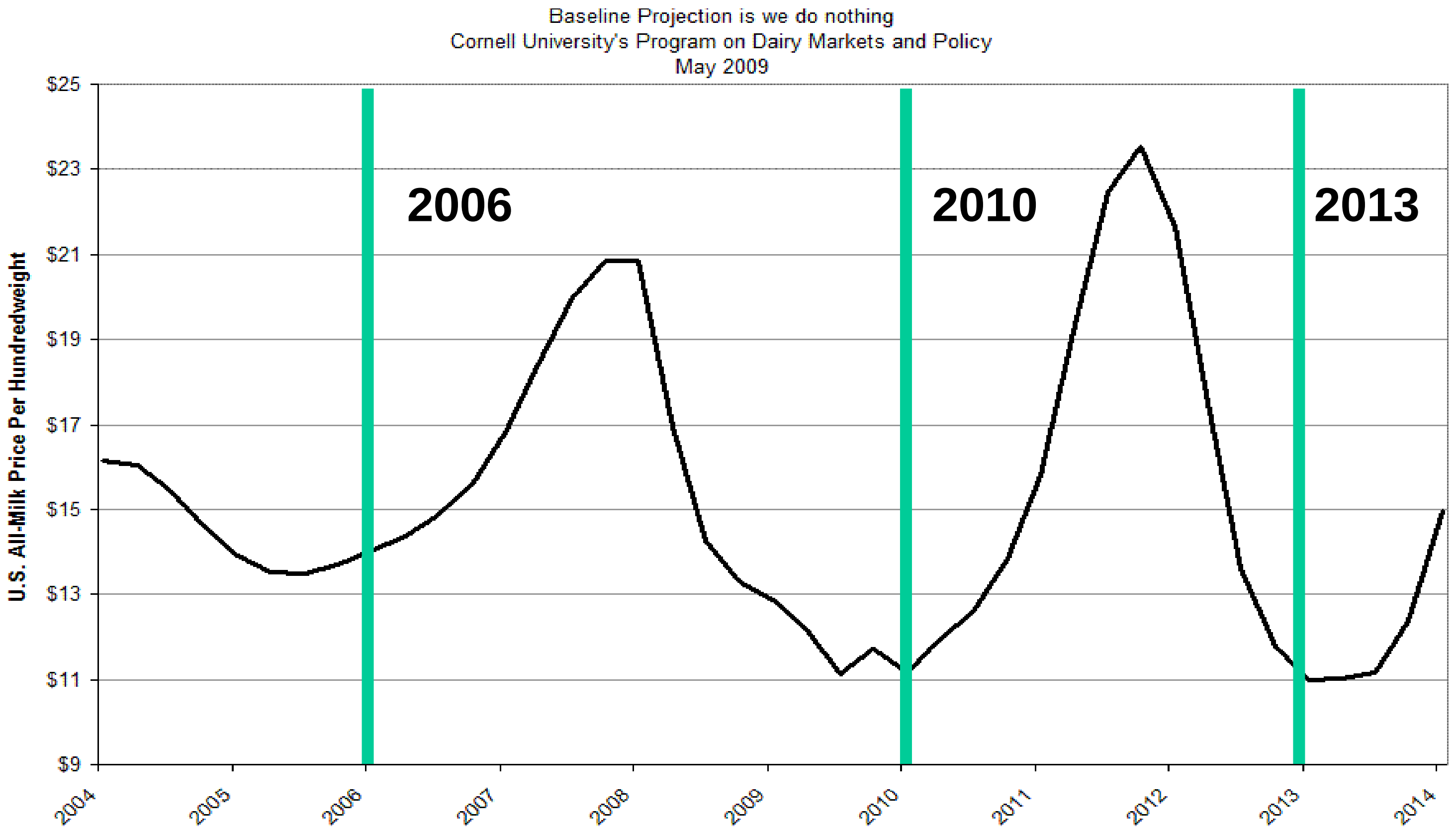
Milk Price Volatility Is Not New…



Courtesy of Cornell University's Program on Dairy Markets and Policy

…But It's Getting Worse With Each Cycle

The Future Projects More of the Same



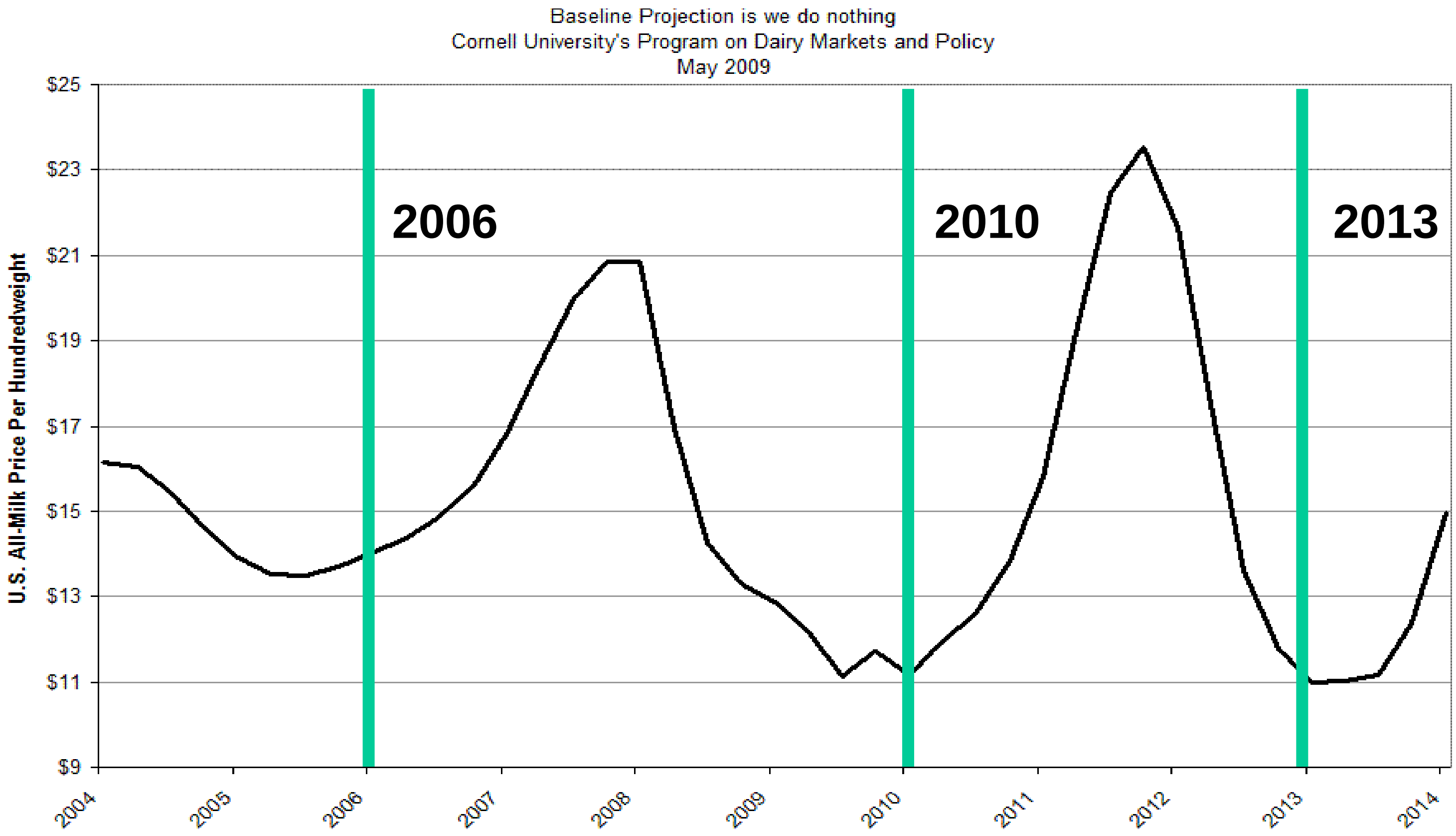
According to the economic model created by Cornell University's Program on Dairy Markets and Policy (CPDMP), this is what the next 5 years could look like.

What’s Changed?

- **Back then…**
  - Small 30-50 cow farms that housed their cows in a fixed tie stall barn, which was not easily expanded.
  - During times of a profitable milk price, that model of dairying could not be rapidly expanded.
  - It took much longer for dairies to respond to profitable prices with production increases.

- **Now…**
  - The “Western-Style” of dairy farming has spread to the entire country.
  - Producers have easily expandable milking facilities, with the know-how, the technology and the capital to rapidly expand production.
  - During times of a profitable milk price, every dairy has the incentive – and the ability – to rapid increase expansion.

This Chart Tells a Story - Supply/Demand



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What Can We Conclude From This?

- Price alone will no longer keep supply and demand in reasonable balance.

- Our industry is hard-wired to overproduce.
  - The “magic of pooling”
  - Our ability to rapidly increase production

- This may be new for us, but most manufacturers have always been able to produce more than the market can absorb.

We need a new tool to keep a better supply/demand balance.

Why Is the Government Involved in Dairy?

- Milk is unique
  - We have to produce it and sell it every day, to a buyer that does not have to buy it every day.
- This creates an unequal balance of power at the negotiating table.
- This is exactly why the industry has had the government involved as a "referee."

So What Can We Do?

- **The Dairy Price Stabilization Program**
  - One stated goal: **Reduce the volatility in the milk price by better aligning supply and demand.**
  - The program creates **incentives, not government mandates.**
  - Over the years, demand for milk has been amazingly steady, 1-2 percent per year, growing largely with population.
  - The problem is when we increase production by 3-4 percent per year.

Why the DPSP?

- **In structuring the DPSP, we had three priorities:**
  - #1 – Reduce milk price volatility.
  - #2 – Do not create a huge barrier to expansion or new entry into the industry.
  - #3 – Avoid creating a significant asset value in the "base."
- **This is why the program is structured to have the lowest "market access fees" possible.**

Dairy Producer Board

The Board sets two numbers each quarter, based on a formula.

Allowable year-over-year growth in milk production per facility. *(normally 1 – 3 percent)*

Market access fee to be paid by facilities that exceed the allowable year-over-year growth in milk production. *(normally $0.50 - $1.50 per hundredweight)*

All market access fees that are paid by expanding dairies will be distributed to all other dairies.

A dairy can choose to maintain its production within the allowable year-over-year growth, and collect their pro-rata share of the market access fees that are paid.

OR

A dairy can choose to expand its production beyond the allowable growth and pay a market access fee for the first year of the expansion.

The decision of whether or not to expand production remains with each individual dairy, just as it is now.

It’s That Simple!

- **Everyone** has the opportunity to start a dairy or expand their production.
- **Nothing** in the DPSP prevents a dairy from expanding.
- Every incentive in the dairy industry (tax policy, pooling, etc.) sends a signal to expand milk production.
- The DPSP aims to send a signal for dairies to manage their production growth.

This is not supply management like we’ve ever seen before…this is a uniquely-American method of production management.

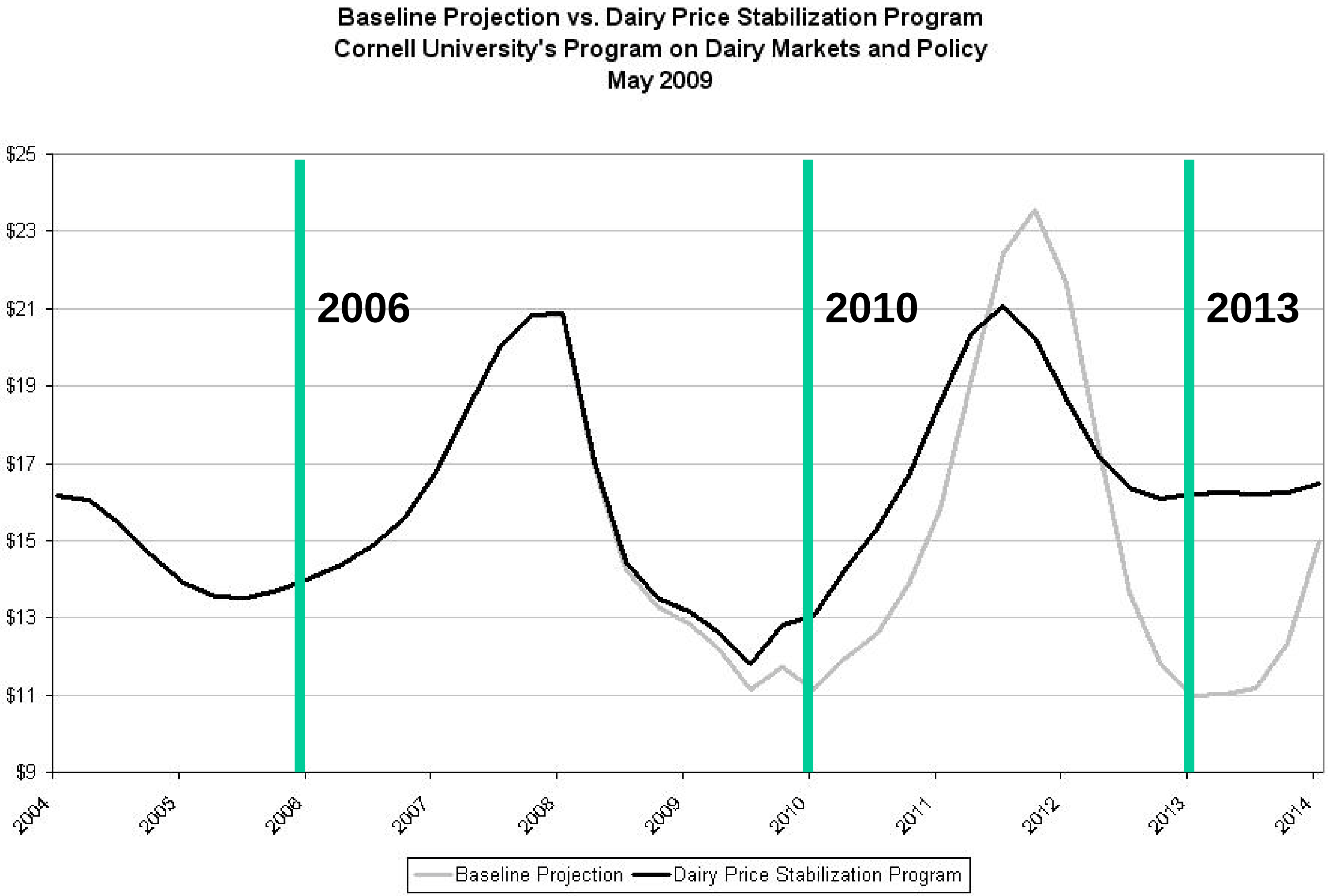
More on the Market Access Fees

- The program announces two levels of market access fee:
  - A lower fee per-hundredweight on **all** the milk of an expanding facility; or
  - A higher fee per-hundredweight on only the **additional** milk produced beyond a facility's allowable production.
- This allows the program to maintain a market access fee **as low as possible** – an important part of avoiding a barrier to expansion and high asset values on "base."

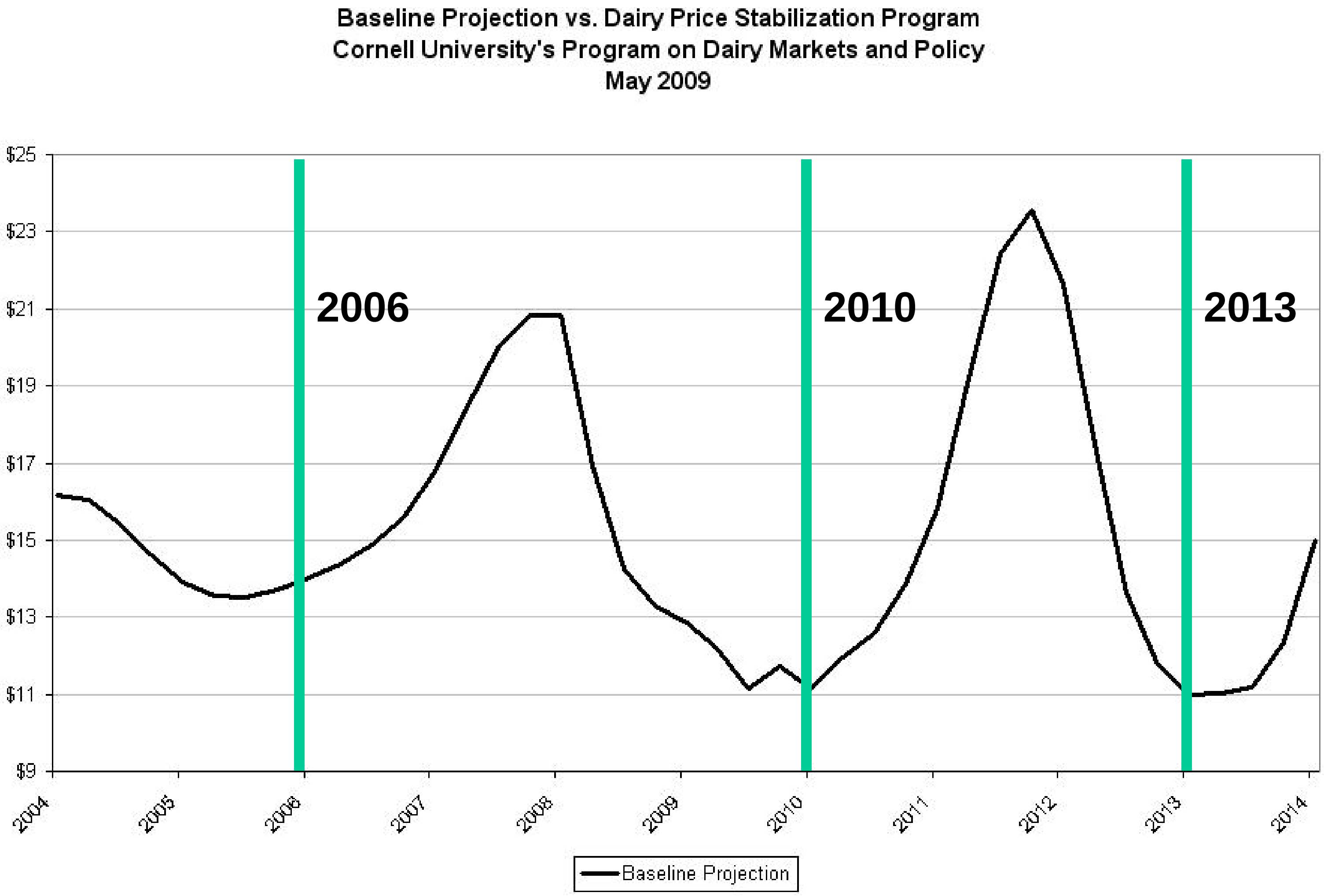
Cornell University's Analysis

- This proposal was taken to Cornell University's Program on Dairy Markets and Policy (Drs. Mark Stephenson and Chuck Nicholson).
- Cornell University has a widely-respected economic model used to project the effectiveness of public policy proposals.
- After running hundreds of scenarios through their economic model, the Cornell model determined that a program structured like the DPSP could, in fact, be effective in dramatically reducing the milk price volatility.
- The model also found that the market access fees could be much more modest than some of the figures discussed in other proposals.

Cornell University's Analysis



We Can't Afford to Wait!



Thank you for your attention

Any questions?

For more information, please visit:

www.MilkProducers.org

www.StableDairies.org