Minutes of the Dairy Industry Advisory Committee
Tuesday, October 12, 2010, through Wednesday, October 13, 2010

The fourth public meeting of the Dairy Industry Advisory Committee (DIAC) was held at the USDA Headquarters, Washington DC, on Tuesday, October 12, 2010, through Wednesday, October 13, 2010.

Committee members present included the following:

Name	**State**	**Business**
Andrew Novakovic, Chairman	NY	Cornell University
Jay Bryant	VA	Maryland and Virginia Milk Producers Cooperative Association
Timothy Den Dulk	MI	Den Dulk Dairy Farm, LLC
Debora Erb	NH	Springvale Farms/Landaff Creamery, LLC
James Goodman	WI	Northwood Farm
James Krahn	OR	Oregon Dairy Farmers Association
Edward Maltby	MA	Northeast Organic Dairy Producers Alliance
Randy Romanski	WI	Wisconsin Department of Agriculture, Trade and Consumer Protection
Robert Schupper	PA	Giant Food Stores
Manuel (Ray) Souza	CA	Mel-Delin Dairy
Patricia Stroup	CA	Nestle
Sue Taylor	CO	Leprino Foods Company, Inc.
Edward Welch	MN	Associated Milk Producers Inc.
James (Ricky) Williams	GA	Williams Dairy Trucking, Inc.
Robert Wills	WI	Cedar Grove Cheese Inc.

Vice Chairman Erick Coolidge, of Le-Ma-Ra Farm, Pennsylvania, and Paul Bourbeau, of Paboco Farms, Inc., Vermont, were unable to attend.

All officers from USDA were in attendance for all or part of the meeting, including:

Brandon Willis, Deputy Administrator for Farm Programs, Farm Service Agency,
Serving as Executive Secretary
Dana Coale, Deputy Administrator for Dairy Programs, Agricultural Marketing Service,
Serving as Alternate Executive Secretary
Solomon Whitfield, Director of the Price Support Division, Farm Service Agency,
Serving as Designated Federal Official
Erin Taylor, Marketing Specialist, Agricultural Marketing Service,
Serving as Alternate Designated Federal Official

Tuesday, October 12, 2010

Call to Order and Opening Remarks, 8:30 AM

Solomon Whitfield, Designated Federal Official, called the meeting to order. Chairman Andrew Novakovic provided a review of the agenda for the meeting.

Subcommittee A Report and Discussion – Options Under Current Law

Subcommittee Members: Paul Bourbeau, Randy Romanski, James Goodman, Patricia Stroup, James Krahn

Jim Krahn introduced the draft report from the Subcommittee on Authorities Under Current Law (Subcommittee A). He stated that feed costs are dramatically increasing and reminded members that industry conditions can change quickly. He said it is important to finish this report so if another crisis develops the Secretary will be able to take the committee's recommendations under consideration and act promptly.

Following up on suggestions for additional information in the draft report, Randy Romanski discussed the USDA Farm Loan Program (FLP). He said that FLP provides direct loans, loan guarantees, interest payment assistance, and emergency loans to farmers. According to Mr. Romanski, in 2009 $6.1 billion was appropriated for the FLP and as of September 10, 2010, 33,000 loans totaling $4.9 billion had been funded. He stated that the top five loan application states in fiscal year 2009 were Wisconsin, Minnesota, Iowa, Texas and Nebraska. He indicated that in Wisconsin, 90 percent of FLP applicants are dairy farmers. He was of the opinion that the FLP is an important source of credit in rural areas when credit is drying up and is vital to farmers who may not have other credit sources.

Jim Krahn discussed Adjusted Gross Revenue (AGR), Adjusted Gross Revenue - Lite (AGR-Lite) and Livestock Gross Margin – Dairy (LGM-Dairy) Programs. He said these programs are currently available to farmers should another crisis arise. He said there are indications that Congress is planning to combine AGR and AGR-Lite into one program that will focus on new businesses and new entrants in dairy farming. There is also a belief that LGM-Dairy will be allowed to expire if something similar to NMPF's proposed margin insurance program is endorsed by Congress. He is of the opinion that the programs in their current form are not widely used because the applications are paper intensive.

Patricia Stroup reviewed specific recommendations included in the Subcommittee A report. The subcommittee believes that the Dairy Product Price Support Program (DPPSP) and the USDA food assistance programs are the only tools available to the Secretary under current USDA authorities. The subcommittee recommends that should another crisis arise the Secretary should encourage purchases of dairy products for food assistance programs as a way to improve market prices. However, they warn that such purchases should not displace commercial sales or harm other parts of the supply chain. The Secretary could also increase DPPSP purchase prices to levels that would undergird the market without driving it to unsustainably high levels. Again, the Secretary should be mindful not to displace commercial sales. The subcommittee recommended that a quantitative trigger be established to determine when DPPSP purchase prices would be increased, perhaps similar to the kinds of triggers now being proposed to trigger a supply growth intervention.

Sue Taylor asked if the subcommittee discussed the unintended consequences of raising DPPSP purchase prices such as a prolonged margin squeeze and the backup of products in the domestic market. Mr. Krahn responded that the subcommittee did discuss those but their focus was how to keep more producers in business during a disaster. He reiterated that farmers need assistance during extreme market downturns. Ms. Taylor asked if it was a logical conclusion that some farmers will not survive the lows and that there would be a supply side correction. Mr. Krahn said that such logic has not played out in 2009/2010 and that he does not believe that a real correction has been made.

Dr. Novakovic returned the conversation to the FLP and noted that the Wisconsin experience using the FLP has been positive and he inquired about the rest of the country. He added that while the FLP is coordinated in Washington, DC, it is implemented on a state/county level, giving the localities some flexibility. He asked if this Federal/State partnership has been successful. Jim Krahn said that the FLP is not widely used in his part of the country (Oregon). Dr. Novakovic asked if lack of use indicated that the FLP is not needed, or rather the program is not user friendly. Edward Maltby was of the opinion that there is distrust in giving business information to the people who administer the program. He added that Farm Credit East is the lender of choice in the Northeast because they understand agriculture, something that he believes is lacking with some FLP officials.

Randy Romanski said that the success of the program is dependent on the effort of State offices to use the program. He added that in Wisconsin the FLP created new partnerships with the private sector to facilitate access to credit so that banks do not have to shoulder all the investment risk. Ms. Taylor agreed and added that in her discussions with many lenders it is the loan guarantee program that is the most viable because banks are not liable for all the risk. Mr. Maltby asked if perhaps the FLP standards should be lowered so that more farmers can access the program.

Tim dun Dulk expressed the opinion of many he has talked to that the industry got into financial trouble because they had access to too much credit and, he said, more credit equals more milk. Ricky Williams agreed and said that 90 percent guaranteed loans do not matter if a farmer cannot show cash flow. Ms. Taylor did not support lowering FLP credit standards. She suggested that Subcommittee A work to get a better understanding of how USDA markets the FLP to banks and what barriers there are to its use.

Deb Erb was of the opinion that extending credit to keep farmers in business was a good thing. She asked what is it that Wisconsin is doing so well because their farm numbers are increasing. Mr. Bryant said that in Wisconsin the FLP is supported at the local level as opposed to the Northeast where there is distrust and not a lot of local support. Mr. Krahn said that the subcommittee will look into what is being done where the program is utilized.

Patricia Stoup continued with the subcommittee's recommendation to increase DPPSP purchase prices when a crisis occurs. She said that anything done to assist farmers in crisis keeps prices lower for longer and the true economic option is to do nothing. However, given that these authorities already exist, the committee should devise a framework around when to increase DPPSP purchase prices. The subcommittee recommended establishing a quantitative trigger for when purchase prices could be increased. A specific trigger would create some expectation in the market and lower risk. Mr. Bryant supported a trigger so that the industry could plan for increases in the DPPSP purchase prices. He does not favor an ad hoc committee that could make decisions that affect price.

Patricia Stroup added that Subcommittee A's recommendations do not advocate for the continuation of the DPPSP program, but it is currently available to the Secretary.

Andy Novakovic inquired about the use of AGR-Lite and LGM-Dairy. Jim Krahn said that what seems to restrict use of the program was the maximum annual revenue that can be insured. He said a lot of the dairies in his state are too big to qualify and that these programs seem to be better suited for smaller, newer dairies.

Break, 10:15 AM

International Perspective: Panel and Committee Discussion, 10:35AM

Paul Campbell, Fonterra Cooperative Group, Ltd.
Rich Lewis, Dairy America, Inc.

Andrew Novakovic introduced the panelists.

Opening remarks of the panel:

Paul Campbell stated that Fonterra is a trader and investor in the U.S. with $2 billion in U.S. sales. Mr. Campbell said the European Union has reformed its agricultural policies which has removed them as a dominant export participant. He noted that while New Zealand's participation in the export market declined 20 percent last year, the U.S. share has grown from 5 to 12 percent. Fonterra believes this trend will continue and the U.S. is well placed to expand its presence in export markets.

Mr. Campbell said that from 2003 – 2008 Southeast Asia and China have increased their dairy imports from 2.4 million tons to 3.1 million tons and Fonterra believes that there is still substantial dairy demand growth in that region. He is of the opinion that this increased demand has led to a structural change in global dairy markets and that there has been a convergence of prices as global trade has become freer.

Mr. Campbell said the U.S. has the potential to grow because:

1) Scale – New Zealand cannot grow quickly enough.
2) Feed – U.S. has a feed based system which can respond quicker to market signals than a pasture based system.
3) Leverage – The U.S. can leverage the intellectual property of its strong domestic processing industry.

He was of the opinion that producers need incentives to produce for the export market and that removing uncertainty creates value for people developing export markets. Such risk management tools as forward contracting, futures, and derivatives are becoming more important and help to reduce uncertainly. From the competitive perspective, he said, the industry must be mindful of non-dairy substitutes as many of these have risk management tools available to them.

Rich Lewis said that Dairy America markets only proteins from nonfat dry milk (NDM). He outlined five issues that are important to Dairy America:

1. Certificates for Trade: Without health certificates they are unable to export products.
2. Free Trade Agreements: U.S. is not as aggressive as Oceania and Europe. He said that if companies can import into the United States and replace domestic sales then United States companies need equal footing outside of the United States
3. Standards of Identity: Skim Milk Powder (SMP) is standardized whereas NDM, which is produced mainly in the United States, is not. This creates a problem where products produced in the United States are not the same as products produced outside of the United States, making it hard to compete for sales.
4. Dairy Plant Equipment Approval: Approval in the United States is more stringent than in foreign countries. The process is lengthy and affects a company's willingness to invest in new product innovations.
5. National Agricultural Statistics Service (NASS) Reporting: He said export contracts are difficult to complete in 30 days and therefore much of that product is not reported to NASS. This places an unfair price burden on California producers because those sales are reported to California Department of Food and Agriculture (CDFA) but not to NASS.

Mr. Lewis said that the U.S. produces 1.8 billion pounds of NDM annually of which approximately 40 percent needs to be exported each year. He told the committee that it is vital to create fairer rules and regulations so that U.S. producers can continue to compete in the growing international dairy market.

A DIAC member expressed the view that the DPPSP inhibits innovation and asked if there are other things that affect innovation. Mr. Lewis responded that the by-products of cheese have no support program and cheese manufacturers have innovated so they are no longer throwing away the by-product. Mr. Campbell said that market signals need to go back to producers and that intervention distorts those signals and creates risk. Mr. Lewis added that the make allowances contained in the price formulas are supposed to return a cost of production back to plants, not be a mechanism to make money. Mr. Krahn stated that conceptually that is true, but for example, make allowances were increased as a response to increasing energy prices but the make allowance were not reduced as energy prices have declined.

Another member said that there has been a structural change in global markets and asked why dairymen should expect returns to be higher than in the 1970s. Mr. Campbell said global milk prices are converging and that prices will be set by a marginal producer and marginal consumer on a global rather than regional basis. He believes that the United States is well positioned structurally to compete for global marginal supply and demand. He was of the opinion that milk prices globally have gone up lately because of the reduction in EU subsidies and that prices are now more rational. However, he said that farmers will still need to see productivity gains.

In response to a question about how New Zealand's dairy industry structure and conditions impacts Fonterra's ability to sell, Mr. Campbell said that Fonterra pays its producers an annual average price which it sets by a formula. He added that New Zealand farmer decisions are made on an annual basis because of extreme seasonality in their milk supply. He said that Fonterra looks at marginal, not average, signals in making investment decisions and they look to invest where they can make the most profit. He said that two-thirds of Fonterra's portfolio is in the dairy ingredients business while the other one-third is its branded consumer business.

One member observed that Fonterra has been investing in dairy facilities in some countries in which Fonterra exports dairy products to and inquired as to how this would impact Fonterra's export opportunities in the future. Mr. Campbell said that Fonterra has been investing in countries where domestic supply growth is not able to keep up with domestic consumption growth. He is of the opinion that dairy exports will remain considerable for the foreseeable future as long as global economic growth continues.

In response to a question on the high land price in New Zealand, Mr. Campbell said that a lot of land in New Zealand is farmland, but this land can be used for many purposes. (ie. dairy, sheep, beef). Recently dairy has been more competitive so land has been going from sheep to dairy production. He added that land prices are set based on expectations of returns for dairy, so as milk prices increased so has land values. Currently, New Zealand land available to dairy is contracting and the speed of conversion is slowing down.

Another member asked how the United States could be a world exporter when Unites States producers have a higher cost of production. Mr. Campbell said that average prices would get to a point where it is profitable for big players to export profitably. He added that Fonterra has confidence that because of its highly efficient systems the United States is prepared to demonstrate long-term sustainable growth. He added that lesser developed countries that have a lower cost of production also have higher risk associated with any investment there.

Another member inquired about using the Chicago Mercantile Exchange (CME) or Global Dairy Trade (GDT) in establishing producer prices. Mr. Lewis responded that the CME could only be a tool if there was more liquidity. He said there is plenty of market information available now, but people need to learn to watch and use that information. Mr. Campbell was of the opinion that the U.S. market is evolving such that more useful tools will be developed for risk management and price discovery. He said that the CME and GDT are current tools available to manage price volatility.

Public Comment Period, 11:45 PM

Kenneth Dibbell, New York Dairy Farmer (retired)

Kenneth Dibbell said that the past 35 years of dairy farming has been a roller coaster and he was not sure how much longer farmer's could survive. He was of the opinion that Dairy America and Fonterra have been profitable to the detriment of U.S. dairy farmers. He urged the committee to concentrate on the domestic dairy industry not the global market. He expressed support for setting producer prices based on cost of production data. He advocated for the Specter-Casey Bill.

Randal Stoker

Randal Stoker offered two proposals that he believes address dairy farmer profitability and price volatility. First, he proposed that Class I differentials be gradually reduced. In his opinion, this would result in farmers receiving more money. Second, he proposed that NASS collect price information on raw milk sales to the first buyer. He said this competitive price data could be released so that producers can see if their price is competitive with their neighbors. He concluded that the way to address the current market problems is with open competition and reduced regulation.

LUNCH, 12:10 PM

Federal Milk Marketing Order Panel Discussion, 1:15 PM

Marvin Beshore, Esq.
Charles M. English, Esq.
John H. Vetne, Esq.
Benjamin F. Yale, Esq.

Chairman Novakovic introduced the four panelists and asked each to make opening comments.

Charles English has practiced as a dairy and agricultural attorney for 26 years. He offered his presentation as a guide to what the Federal milk marketing order (FMMO) program is authorized to do. The following are highlights from the presentation:

1) Unlike states, the program is authorized to regulate interstate commerce.
2) The program collects and publishes non-individualized market information that is vital to the industry.
3) The program allows cooperatives to submit documentation to qualify them to act on behalf of their producer members in Federal order matters.
4) The program has uniform minimum price authority – it enforces classified payments from handlers and minimum uniform prices to producers.

John Vetne has been involved in Federal milk marketing order regulation for 37 years. He said the procedural rules applicable to the FMMO program have not changed since the 1940s. He mentioned examples of other agencies that only hold formal rulemaking proceedings if there are factual disputes – all other amendments are handled through informal rulemaking. He was of the opinion that this should also be done with amendments to the FMMO program. Additionally, he stated that the expansion of the geographic size of Federal orders has helped eliminate much of the parochialism that is inherent with smaller orders. Lastly, he was of the opinion that the problem with the current pricing system is that it no longer prices milk at the value of the market to which it is delivered.

Marvin Beshore said that he had worked in the USDA Dairy Division while in law school and has a private practice handling issues relating to Federal and State dairy marketing orders. He stated the FMMO program is not authorized to administer a supply management system. However, he said the FMMO program could decouple the Class I price and instead set a Class I price floor. He believes that the additional revenue could be pooled nationally and this would help stabilize producer prices.

Benjamin Yale stated that there are services that the FMMO program does well. He said the field employees who administer the program are trusted by both buyers and sellers, and the Market Administrator offices conduct important component testing and verify weights and measurements. He was of the opinion that the program does not use its authority to referee disputes between producers and handlers, as is done in the fruit and vegetable industries. He said that the resources were never provided to make the end-product pricing system work and that the price formulas do not encourage milk to move to its highest valued use. He thinks that a lot of the current price volatility is a result of the Class III and Class IV prices which he says are ultimately based off the CME. He said that there are no longer other market forces that would mitigate the influence of the CME. He stated that Class II, III and IV prices should be deregulated. He noted that there has been no formal rulemaking proceeding in the Southwest order since 2000 which he attributed to cooperatives in the region working together to solve issues. He believes the same cooperation should be sought in other regions of the country.

One member asked Mr. Yale to elaborate on his suggestion to deregulate all classes of milk except Class I. Mr. Yale said that currently any product that does not fit into the standards for Class I, III and IV is automatically given a Class II designation. He believes that this discourages product innovation using dairy ingredients. Deregulating manufacturing classes, he said, would encourage handlers to develop new innovative uses for dairy derived ingredients. Mr. Vetne was of the opinion that it would be efficient for the industry to head towards fewer classes of milk. He said the FMMO program can still exist by just providing market information and possibly using currently unused authorities. Mr. Beshore questioned the logic behind combining cheese, butter and NDM into one class when the products have different functions. He stated that butter and NDM plants provide market balancing functions and cannot afford to pay cheese prices for milk.

Another member asked how the FMMO system was impacted when Idaho producers voted to repeal their Federal order. Mr. Yale was of the opinion that right now Idaho producers would probably say that the absence of a Federal order is not working in their best interest.

In response to a question on whether a FMMO system would adequately compensate entities for balancing the market's surplus milk, Mr. Beshore and Mr. Vetne agreed that the Agricultural Marketing Agreement Act of 1937 was amended in 1985 to allow for payments from the marketwide pool for services of marketwide benefit. Mr. Beshore added that there are a few FMMOs that already establish marketwide service payments.

Another member asked if litigation, and the costs associated with litigation, would disappear if there was no FMMO system. The panelists agreed that there would still be litigation, just of a different type. Mr. English said that the FMMO system is a zero sum game – if someone wants something another person has to give something up. Mr. Beshore disagreed with that assessment and argued that classified pricing enhances producer revenue; it is not a zero sum game in the aggregate.

When asked about public participation in the formal rulemaking process, the panelists said that the rulemaking hearings are open to the public and anyone can participate. Mr. English added that USDA actively participates in the hearing in the public interest. When pressed further on whether USDA employees have a pecuniary interest in what decisions are made, Mr. English noted that the USDA decision makers are at USDA headquarters in Washington, DC. they are not the individuals in the field administering the program. Mr. Yale added that the objective of the FMMO program is to provide market stability and that is in the public interest.

When asked what the dairy industry could learn from other similar commodities, Mr. Vetne responded that a close parallel to dairy, in perishability, is eggs. He said that the egg industry has 2 classes of use (shell eggs and breaker eggs) and over time the industry has become more consolidated. He is of the opinion that the FMMO system has allowed smaller producers to survive and that the system could continue to be a benefit to producers without classified pricing.

One member asked each panelist if they could start from scratch what type of pricing system would they design. Mr. Yale stated that sometimes entities ask too much of the government when instead they should let the industry do what it does best. Mr. English was not of the opinion that the current system is price enhancing, and he reminded members that the FMMO system sets minimum prices to provide a basis for fairness and equity. Mr. Vetne observed that each time the FMMO system is amended it reduces the market's ability to respond to signals. Mr. Beshore added that the FMMO system provides protection to smaller producers, and he questioned what would happen to those producers without the system.

Another member stated that the FMMO system only requires the regulation of Class I handlers and all other handler participation is optional. They asked why there was not more depooling of non-Class I milk. Mr. English said that much of the Class II processing is conducted at Class I plants, so in effect that processing is caught up in regulation. Mr. Vetne challenged the assumption that some handlers can voluntarily participate. He added that for a producer's milk to become qualified for pooling they must deliver milk to a pool plant. He argued that this system causes producer milk to be hauled longer distances solely to become qualified.

One member brought the discussion back to a possible floor price on Class I milk and they argued that it would be destabilizing because it would cut off market signals to producers. Mr. Beshore disagreed and said that there are many stops in the marketing chain between producer prices and retail prices, therefore there is not a one-to-one relationship between the two. He was not of the opinion that putting a price floor on 35 percent of producer milk would create a market disruption. Mr. English does not think there should be a Class I price floor because supply and demand need to be reflected in prices.

Another member inquired about marketing agreements in common (MAC) in the Southwest. Mr. Yale said that the power of a MAC is enhanced efficiencies between cooperatives. He believed it would be helpful if USDA enforced MACs. Mr. Beshore stated that MACs cannot be enforced on individuals that are not part of the MAC unless it is converted to a Marketing Order or a Marketing Agreement.

Another member stated that the AMAA provides that producer prices should be established as they relate to the cost of production. They said that historically USDA had determined that some price less than the cost of production generates an adequate milk supply. Mr. Yale confirmed that courts have continuously found that USDA adequately addressed producer cost of production when it determines its minimum producer prices. However, he believes that is has been a mistake for USDA to not look at the economic well-being of individuals at the farm level.

Break, 2:30 PM

Bob Wills was of the opinion that the FMMO panelists agreed that the end-product pricing system has not worked as intended and contributes to volatility. He asked if there was consensus among committee members to recommend eliminating end-product pricing and suggest a competitive pay price system. Ms. Taylor agreed that the current pricing system contributes to volatility, but she would need to see how a competitive pay price is structured before she could endorse that type of pricing mechanism.

Andrew Novakovic stated that the three options for Federal order pricing formulas are fix them, replace them, or eliminate the need for the formulas by deregulating manufacturing classes. Mr. Krahn reminded members that no proposal can stand alone and they need to look at their recommendations as a package. He said he could support paying plants that provide market balancing services but only if make allowances and provisions that allow depooling and pool-loading are eliminated.

Dr. Novakovic reviewed the Foundation for the Future (FFTF) plan that proposes deregulating milk used in Class III products and the Maine Dairy Industry Association proposal to deregulate by geographic region. He asked if the members preferred any of these methods. Mr. Krahn said that in the West FFTF would be a more logical approach. Mr. Wills said that he has concerns with either approach. He does not think that the committee has been presented with enough evidence to demonstrate how classified pricing enhances producer prices. He thinks a more free market pricing system that allows for only the distribution of Class I premiums would be more appropriate. He does not believe that producers would lose revenue going from four to two classes of milk.

Sue Taylor said that perhaps they could agree on the implications of the current pricing system:

1) The biggest distortion is multiple manufacturing classes that lead to increased price volatility because milk does not go to its highest use;
2) End product price formulas contribute to increased volatility; and
3) Handlers make products used in the formulas which lead to the safest, but not most profitable investment decisions.

Ed Welch said while he agrees that end-product pricing leads to volatility, he is not ready to support two classes of milk.

Dr. Novakovic stated that an assumption that Ms. Taylor is making is that a manufacturer's incentive to hold onto milk is different than a supplier's incentive to move milk. Ms. Taylor said that in her experiences with the nine Leprino manufacturing plants, decisions on milk allocation vary across markets according to who has the highest premium. Mr. Krahn said there are other reasons for moving milk such as plant capacity. Mr. Welch agreed and said he would not move milk out of a cheese plant if the returns are better for NDM because the cheese plant would lose efficiencies generated by operating nearer capacity.

Ms. Stroup said that classified pricing does enhance volatility because that is why manufacturers strive to keep their plants operating at full capacity; investment decisions were made because of the classified pricing system. Mr. Wills added that all plants provide market balancing services and if milk flowed more easily between classes then there would not be manufacturing plants solely devoted to balancing the market. Ms. Taylor said in the long-run, the incentive to produce NDM as a default product because of the DPPSP needs to be removed. Only then, she said, will there be more innovation in the industry.

Dr. Novakovic moved the conversation to dairy farmer profitability and asked if it is enhanced because of the classified pricing system. Mr. Goodman said that because there is limited competition how can producers assume they are getting a fair price. Mr. Wills agreed with the problems caused by consolidation and said it leads to opportunities to manipulate the market. Mr. Krahn agreed with a FMMO panelist that said classified pricing enhances producer prices historically around 15 cents/cwt. He asked how producers would recoup the 15 cents if they eliminated classified pricing.

At the end of the meeting Dr. Novakovic said that the final report should be drafted by the end of January. The committee outlined some of the topics they had discussed during the day and assigned relevant subcommittees to look into them further.

Adjourn, 4:00 pm

Wednesday, October 13, 2010

Call to Order and Opening Remarks, 8:00 AM

Solomon Whitfield, Designated Federal Official, called the meeting to order.

Dr. Novakovic reviewed the day's agenda and said they first needed to finish discussing the Subcommittee A draft report.

Ms. Stroup discussed the changes to the report that resulted from yesterday's discussion. At the end of the section on FSA FLPs the subcommittee recommends that USDA should share best practices from across other regions where the program is successful. Additionally, the subcommittee recommends using a quantitative trigger, such as milk price over feed cost, to determine when the Secretary should investigate whether a change in the DPPSP purchase prices or increasing food assistance purchases is needed. She asked the committee how specific they wanted to get in providing the details of a trigger.

Dr. Novakovic suggested they describe the trigger, not necessary provide detailed specifics. Mr. Welch suggested a similar trigger to the growth management triggers that are contained in FFTF. Ms. Stroup suggested providing a range. Mr. Wills reminded members that they need to be cognizant of the budget implications with any of their recommendations. He also suggested that USDA review their purchasing processes in order to make commodity purchases in a timelier manner.

Dr. Novakovic contrasted purchases under the DPPSP vs food assistance programs. He said USDA offers a price and product specifications for government purchases of cheese, butter, and NDM under the DPPSP. For food assistance program purchases, USDA announces an offer and accepts bids. Other members added that only domestic products can be purchased through these programs.

Mr. Wills asked if the process should be streamlined to become faster and more predictable. Mr. Souza added that perhaps the packaging requirements could be changed.

The conversation then moved to the possible use of vouchers in lieu of increased government food assistance purchases. Mr. Krahn suggested that perhaps the government could issue vouchers for purchases direct from retailers that the store would then submit for reimbursement. He believed this would have less impact on commercial displacement. Tim den Dulk questioned that assumption.

Dr. Novakovic discussed the various government food purchase programs. He said that the Commodity Credit Corporation can purchase products for the purpose of supporting agricultural prices. Another program is the Supplemental Nutrition Assistance Program (SNAP) (also known as food stamps) which accounts for two-thirds of USDA's budget. The Women Infants and Children (WIC) program is not dairy specific but it has an unusually high impact on dairy because of the important role assigned to dairy products for the target clients. The School Milk program is dairy specific, but the problem is that most school districts plan out their purchases so it would be hard to distribute additional dairy products during the year. Dr. Novakovic said the most appealing program to move dairy products with little commercial displacement is TEFAP (The Emergency Food Assistance Program). He stated that Section 32 funds cannot be used to buy products already supported with a price support program, but perhaps those funds could be used to buy other dairy products such as yogurt. He cautioned that there is a lot of competition for those funds by commodities that have no price support programs. He also said there are other international food assistance programs but believes it would be more appropriate to look at domestic programs.

Mr. Krahn mentioned that the local dairy promotion programs have nutritionists that work with schools and the WIC program to send out recipes with dairy product ingredients. Mr. Maltby questioned whether that was happening everywhere and stated schools are becoming more concerned with caloric intake.

Mr. Williams and Mr. Schupper said that oftentimes food banks do not take government cheese donations because it is either a specific product they cannot use, or they do not have refrigerators for storage. He was of the opinion that a voucher program would eliminate these issues. Ms. Taylor said that USDA has done studies on commercial displacement that the committee should look at. She was of the opinion that vouchers do not move more product as consumers merely use the money saved to buy other items.

Cathie McCullough from the USDA Food and Nutrition Service (FNS) noted that there is an endless need for product as long as it is a donation. A problem arises when program funds are needed for purchases. Mr. Krahn asked about the use of vouchers. Ms. McCullough said that FNS does not have a vehicle for a voucher program, and she would guess that a voucher program would displace commercial sales. She added that recently $6 million in grants was distributed to food banks for infrastructure improvements such as refrigerators.

Mr. Schupper added that there have been changes to the WIC program so that there are a variety of products, including dairy products in certain package sizes that are no longer WIC eligible.

Ms. Taylor returned the conversation to what triggers the committee could recommend to the Secretary to use as a basis for evaluating a change in the DPPSP purchase prices or increasing food assistance purchases. She believes that raising the DPPSP purchase prices would ultimately hurt producers and thinks there are other tools that can be used to address farmer margins. Mr. Wills noted the budget complications with increasing purchase prices and suggested that the Secretary be able to evaluate relevant industry needs to provide justification for moving money between commodities. Mr. Souza suggested that maybe they could look into indexing the support price levels. Milt Madison of USDA agreed to provide the committee with information regarding indexing that the Farm Service Agency had already put together.

Ms. Stroup reiterated that the recommendations in this report do not suggest that the DPPSP should continue, they simply recommend how the DPPSP could be used as it is nearly the only tool currently available to the Secretary.

The committee discussed a specific paragraph in the report (page 66, lines 16-19). Many producer members were uncomfortable with the assertion that increasing prices would constrain sales. Ms. Taylor stated that she thought the sentence was simply a logical statement about how markets work. Mr. Goodman noted that just because retail prices increase does not mean that farmers are paid more for their milk.

Ms. Stroup stated that according to economic theory, unless the price elasticity is zero, if prices increase then sales decrease. Mr. Schupper said that when prices go up consumers will see promotions to encourage sales. He stated that when milk prices were high in 2007, people started buying half-gallons instead of gallons and they have never returned to their old purchase habits. He added that, for example, when butter gets expensive people will substitute margarine.

Mr. Souza said that it is the excessive prices that are the problem. Mr. Bryant suggested that the word "farmer" be removed and the sentence could be changed to reflect that price increases could have an impact on the whole industry.

Break, 9:20 AM

Committee Discussion, 9:45 AM

It was agreed that Subcommittee A would work on the previously mentioned sentence and the other parts of the report taking into account the Committee members concerns. Committee members will send any additional proposed changes to Ms. Stroup. Subcommittee A will email the updated document to members in November and there will be a vote to accept the report at the December meeting. The members thanked Chairman Novakovic for his help in drafting Subcommittee A's report.

Jacqueline Klippenstein, Dairy Farmers of America (DFA) Vice President of Legal Affairs, asked to address the committee. Ms. Klippenstein reviewed DFA's approach for the next farm bill's negotiations. She said that DFA is working to address issues such as refrigeration with the food bank system. When discussing a voucher program, Ms. Klippenstein said the committee should be mindful that the food bank system and the SNAP program have different target populations. She also said that DFA is concentrating efforts on a Buddy Pack program which gives one meal to kids to eat on weekend's because these children often have no other nutritious meal when not in school. According to Ms. Klippenstein the buddy packs have 2 single serve milk boxes. Ms. Klippenstein said she would submit written comments to the committee outlining her verbal comments.

Review of Public Comments, 10:00 AM

Dr. Novakovic summarized public comments that have been received via online, postal, or electronic mail. He highlighted the primary themes which include:

- General requests to assist dairy farmers;

- Increasing the DPPSP purchase prices;
- Concern regarding the importation of milk protein concentrates and caseinates. Some commenters said that imports should not be allowed if domestic prices are below a specified level;
- The degree of competition and price discovery;
- Concern with the role the Chicago Mercantile Exchange plays in price discovery;
- Support of growth management;
- Adopt the California milk solids standards, both for and against;
- Endorsement of Country of Origin Labeling (COOL) requirements for dairy products;
- Support for regulations making it illegal to use foreign ingredients in milk products;
- Support for a Canadian style supply management system;
- Raising the issue of somatic cell counts in milk;
- Banning the use of rBst;
- Protecting animal welfare;
- Support for Senate Bill 1645;
- Constraining imports under certain conditions;
- Two classes of milk;
- Support for mandatory price reporting;
- Opposition to a supply management system; and
- Support for legalization of raw milk sales.

Mr. Goodman asked whether the Secretary has the authority to floor the milk price. He elaborated that some think that the Secretary has unlimited funds to increase DPPSP purchase prices or that he has the authority to set a mandatory price floor. Dr. Novakovic stated that the Executive budget process requires USDA to reallocate the funds for any increase in DPPSP purchase prices from another funded program.

Most members expressed that almost all of the issues highlighted in the public comments are already being addressed within the subcommittees. Dr. Novakovic stated COOL has not been discussed and suggested that it be looked at by the Profitability Subcommittee.

The members discussed raw milk sales and the consensus was that the issue is a State issue. The members also stated that most of the components of Senate Bill 1645 are already being addressed within the subcommittees.

Mr. den Dulk said the committee has been functioning under the assumption that there is too much milk. He said that there has been a substantial increase in feed prices recently – corn is now trading at $6 per bushel, which is higher than the 2008 average price, at the same time that feed inventories on the farm are low. He was of the opinion that this will affect all dairies and result in loss of production. He offered that the committee should consider the possibility that there could be a period when the United States is milk deficit. He added that right now the Class III price is $3.50 per cwt less than in 2008 when there were record high feed prices.

Mr. den Dulk also said that margins could get so low that they could reach a level that people thought would not be reached again. The committee discussed the higher feed prices that are projected for the future and discussed federal policy to encourage the use of corn-based ethanol as a contributing factor.

Lunch, 11:45 AM

Committee Work Session, 1:00 PM

Subcommittee B Report and Discussion – Dairy Farmer Profitability

Subcommittee Members: Paul Bourbeau, Erick Coolidge, Edward Maltby, Randy Romanski, Ray Souza, Patricia Stroup, Edward Welch, Ricky Williams, Robert Wills

Mr. Maltby reviewed the draft report from the Profitability Subcommittee. The subcommittee held two conference calls since the September DIAC meeting. The subcommittee believes there are three different time periods that the full committee should provide recommendations to: 1) Immediate recommendations that could be administered in 2011; 2) Short term recommendations that could be implemented between now and 2014; and 3) Long term solutions that could be part of the new Farm Bill.

The subcommittee said that many months of higher stable producer-pay prices are needed to restore lost business equity and liquidity that resulted from 2009. They think that farms under the most financial pressure are those that purchase feed, have highly leveraged assets, and/or rely on a cash-flow business model, i.e., they lack the reserves or other alternative income to meet cash obligations when cash income from milk suffers. The subcommittee was of the opinion that a major crisis could occur in the next 6 months due to: 1) increased Federal regulation on lenders; 2) lack of lender confidence; 3) too small of a producer price rebound; and 4) higher grain prices.

Mr. Maltby discussed five subcommittee recommendations: 1) increase the fluid milk solids standard for beverage milk products; 2) amend the Federal milk marketing order program to reflect competitive pay prices and increase price transparency; 3) adoption of the FFTF growth management program; 4) increasing counter-cyclical payments for environmentally friendly practices; and 5) increase grant based incentives targeting smaller dairy farm operations that have greater risk. Mr. Maltby concluded that the members need to decide what they want the industry to look like in ten years and then they can recommend policies that will move the industry in that direction. In his opinion, if the strategy is to be low cost and produce for the export market, then dairy farmers will need to get bigger.

Mr. den Dulk did not agree that farmers either need to get big or get out. He stated that there are many large dairy farmers who are in financial trouble while at the same time there are small farmers who are doing fine.

Mr. Schupper also said the members may want to consider that there could be a crisis on the processer side as there has been a lot of consolidation on the processing and retail side. He said that consumers like larger retailers because of the efficiencies they offer, but that can have negative impacts on dairy farmers. Mr. Wills said that the price problems that effect processers are not necessarily simultaneous with the profit problems of farmers. He said that high producer prices in 2007 had the same impact on processor equity as the low producer prices had on farmers in 2009.

Mr. Bryant agreed with Mr. Will's assessment. His cooperative owns and operates processing facilities and in 2007 its equity shrunk considerably. He said the problem was the rapid movement in prices that did not allow them to pass on a margin, not necessarily the actual price level. Mr. Bryant also agreed with Mr. den Dulk's assessment. He said they should not turn their discussions into a big versus little comparison. Mr. Krahn agreed that the number of milk cows no longer determines a farmer's profitability.

Mr. Welch disagreed that cooperative equity has been eroded to the same extent as producer equity. He also argued that there are still some efficiencies on large farms in certain regions of the country. He added that farms in New Mexico are producing milk profitably while receiving $3 less per cwt than farms in Wisconsin, for example.

Mr. Souza said that in his opinion, the greatest impact on producer profitability has been the government's ethanol policy. He does not believe that there has been a sustainable producer milk margin since 2007.

Ms. Taylor referenced the subcommittee's recommendation on increased counter cyclical payments for environmentally friendly practices. She would like to see decoupled payments that would not be tied to actual production so there would be less market distortion but still support the rural economy.

Mr. den Dulk noted that the cost of production in the Southwest is around $17 per cwt. He is of the opinion that USDA data usually shows a lower cost of production figure but he does not believe that it is reflective of average farms in that region.

Mr. Romanski said there has been growth of dairy farms in the Midwest because of modernization efforts, not because of any particular business model or herd size.

Dr. Novakovic asked the committee to try and frame their conversation by expressing what their intentions may be, for example, are they trying to improve price or margin? Are they trying to protect or grow the market? Should there be a national policy prescription or some allowance for regional flexibility?

Ms. Stroup asked if when they talked about profitability if the members meant per unit or per farm. She argued that increasing profit per unit is not sustainable in the long term; the committee instead needs to focus on increasing the number of units sold. She struggles with concepts that would artificially increase milk prices in the short run because those people who are already successful will do better, while those that are already disadvantaged will not be helped in the long run. She is of the opinion that the purpose of the Profitability Subcommittee is to look at how USDA can remedy inequities, not artificially increase prices.

Mr. Souza said that the committee needs to look into establishing safety nets, not guaranteeing that every farm is profitable.

Dr. Novakovic asked if it was possible or desirable to talk of a national benchmark on farm performance. He stated that the National Milk Producers Federation (NMPF) considered regional solutions but ultimately decided that a national milk price over feed cost measure was more feasible.

Mr. Bryant stated that NMPF debated a national versus regional policy, but that if they focused on prices or cost of production it was difficult to design a national policy. He said that is why NMPF relied on margins when designing FFTF because they found the relationship between price and feed costs is similar around the country.

Mr. Welch and Mr. den Dulk agreed that regional issues could be addressed by focusing on margins instead of prices. Mr. den Dulk pointed out that a concern could arise when the price of an alternative crop in one specific region increases substantially, but the national margin remains the same.

Dr. Novakovic pointed out that many Farm Service Agency programs are operated with state-wide data and perhaps a growth management program could do the same. He asked members to discuss whether a growth management trigger should be applied equally in all locations or have regional differences

Ms. Stroup stated that she did not see how a national growth management program could be effective. She said there are regions of the country such as the Southeast that have been experiencing a milk deficit and asked why those farms should be adversely affected by a national program.

Mr. Krahn agreed that some regions of the country did not increase milk production as much as others. However, he believes that it would be ineffective to rely on certain regions to fix the problem that they created. Mr. Krahn argued that FFTF would be an effective program and is politically feasible at this time. He also said that all farmers have increased milk production in some way, either by increased milk per cow or by increased cow numbers.

Mr. Wills said the problem should be looked at by product segmentation not geograpahicarea. He stated that if certain sectors of the market (organic, Greek yogurt, and other value added products.) have increasing demand then decreasing milk production would harm those growing product lines. He argued that all product categories cannot be treated the same and a national growth management program is fraught with problems.

Ms. Taylor said that the committee needs to look at a long-term package of policy proposals. She said that growth management is not the only prescription for addressing the problems from 2009, there are other policy options such as margin insurance and farm savings accounts.

Mr. Wills said that the committee has overlooked the question of externality effects. He supports policy options that would keep a larger number of producers in business than would be otherwise. If not, he said, the outcome may end with an industry and rural communities that people do not like. However, he does not support a supply management program.

Mr. Souza discussed what he sees as the differences between the typical business and a farm business. He said that farmers have an emotional attachment to their business and often they do not respond to market signals; they are willing to stay in business until the very last minute. He said there are farms now that are still in business when they should be looking for ways to get out. Therefore, he said, a safety net program is needed to help the industry adjust to the current market environment. He was supportive of a growth management program that responds to serious shocks.

Mr. den Dulk said he does not believe that a growth management program would solve a price problem. Mr. Krahn said that the FFTF has many pieces to the puzzle – growth management is only one of them. Ms. Stroup asked if instead of growth management the committee could look more closely at a farm savings account program that has the same impact on volatility but without the negative consequences.

Break, 2:30 PM

Committee Work Session, 3:00 PM

Dr. Novakovic discussed the items that the committee will need to address at the December meeting. Those include finalizing the Current Authorities Report and continuing the Profitability and Volatility Subcommittee discussions. The DIAC will meet again December 14-16, 2010. The final DIAC meeting will be in January 2011.

Some members expressed a need for additional information from various panelists before they could vote on any recommendations. In lieu of inviting more outside speakers to the December meeting, the members agreed to submit written questions to USDA in November. USDA will distribute the questions to relevant panelists and attempt to collect and distribute responses to DIAC members as well as post them on the public DIAC website before the December meeting.

Dr. Novakovic changed the conversation to explore members opinions as to whether there are policies that could stifle innovation and/or be looked at as protectionist. Ms. Taylor said that the committee should recommend a set of policies that facilitate a healthy dairy industry including standards of identities and other issues that affect farm health.

Mr. Wills said that the value of milk is determined by what consumers are willing to pay, therefore an increase in value added products means an increase in the milk price. He concluded that they need to increase the overall milk demand, not single out any one specific product. Mr. Bryant said that a few Maryland and Virginia Milk Producers Cooperative members have begun on-farm bottling in order to have some way to cover their cost of production. However, he agreed with Mr. Wills that the best way to help all dairy farmers is to grow the entire market.

Some members also brought up the topic of dairy check-off monies and whether some of that money could be returned back to farmers. Dr. Novakovic said that according to the authorizing legislation, check-off monies can only be used to promote or otherwise increase the sale of milk and dairy products.

Other members also brought up the topic of immigrant labor which they said is essential to the dairy industry. It was agreed that this topic is worthy of a mention in their final report, but that it is not a USDA issue.

Adjourn, 4:00 PM