The Strategic Dairy Reserve
Position Paper On The Dairy Industry
By Marc Perosio

DEFINING THE PROBLEM (SHORT, MID AND LONG TERM)

SHORT TERM ACUTE PROBLEM. 8 billion lb surplus. Causing a dramatic drop in farmgate prices for 2009 which are avgeraging $7.50 less than 2008. Reference farm credit data published September 2009.

MIDTERM PROBLEM. TB and Johnes continue to threaten nations herd. Once the knowledge of TB makes its way to consuming public, it could have catastrophic effects on demand. Johnes continues to be a persistent yet unsloved problem that is plaging the dairy industry.

LONG TERM PROBLEM. Antiquated federal milk marketing order and pricing system that lacks the flexibility that the world market demands. There is no supply management tools. The present systems has worked for a long time but is in need of modernization.

SOLUTIONS

Payment for the short mid and long term solutuions Utilize federal loan guarantees administered through National Milk Producers Federation (NMPF). Repaid , in full, by a 40cent/cwt assessment on all milk produced in the country. This will be mandatory. Discussion of the numbers will occur later in this paper.

SHORT TERM SOLUTION Herd reduction of 8 billion lbs of milk through the existing CWT program (Cooperatives Working Together) through the Natonal Milk Producers Federation (NMPF)

Cost of removing 8billion lbs of milk at $6/cwt or $480 million dollars. Repayment will commence 6 months after completion of the herd reduction. Markets will have risen enough to allow farmers to handle the assessment without burden. This will dry up the surplus of milk. This portion of the solution can be implemented quickly with existing infrastructure.

MID TERM SOLUTION Test and remove all diseased mature dairy cattle from the national milking herd over a four year period. Test 25% of every cow in every state each year and remove the diseased animals. Concentrate on the cows infected with TB first, as they are the biggest threat to dairy farmers and the consuming public, then focus on the johnes cows. Pay the farmer $2000 for each diseased animal removed and pay for the cost of testing. Which is estimated to be $12 / cow. Cornell University estimates that there may be 1.3 million animals that could be removed by this program, at a cost of 2.6 billion dollars. Testing will cost 108 Million dollars. Total cost of this would be 2.708 Billion dollars.

SUMMARY OF COST AND PAYMENTS FOR SHORT AND MID TERM

Short term cost 8 billion lb surplus removed @$6/Cwt Totaling 480 million dollars
Mid Term cost 1.3 million cows removed @ net cost $2012/ head Totaling 2.708 billion dollars.

REPAYMENT 40 Cent/cwt on all domestically produced milk generating $735 MIlion annually. Commencing 6 months after the program becomes operational. Markets will have tightened and farm gate prices will have risen enough so that the assessment will not be burdensome. Estimated 4.3 years to repay loans. The midterm solution can be implemented quickly and efficently.

SOLUTION FOR THE LONG TERM. During the four years of the diseased cattle removal program rewrite the federal milk marketing orders and pricing systems to reflect the markets of the 21st century. I recommend the formation of the strategic dairy reserve(SDR) This would replace in name and function the CCC (Commodity Credit Corporation). However, it will NOT require any new storage facilites for milk or products. The SDR will use existing frame work and structure of the CCC.

The SDR would work in this manner. Sellers of products sold at the CME (Chicago Mercantile Exchange) can sell to the SDR at anytime for the markert price of the day. If the SDR inventory grows, for example, to greater than 1% of demand, supply management tools are automatically instituted. Such as (DEIP) Dairy Export Inhancement Program) give aways to schools ,charites the WIC programs and the Food Stamp programs . If inventory in the SDR grows to a 2% surplus , for example, automatically a herd reduction is initiated and cows are removed. A preset dollar /cwt is posted at the time of the herd reduction. This can be adjusted up or down by NMPF to attract cows quickly to stop the growth of supply allowing markets to tighten. Thus putting brakes on the downward slide of prices.

It has been clearly demonstrated that when supply equals demand prices go up to farmers. Consquently when supply out strips demand, as we have seen in 2002-03, 2006 and most severly 2009, prices are driven down very fast very far. Reference table1. When prices are up supply and demand are insync. Consequently when they are down supply outpaces demand.

When world markets become tight,as in 2007 and 2008, supply of products became short and prices rose quickly. The SDR would have enough product in storage to mitigate the tightness of the market. The SDR would be allowed to sell to the domestic or world market on a free market basis. This will assist in keeping prices from rising too far too fast. However counter productive this may appear, it far more important for dairy farmers to have price swings of $3-4 /cwt than $10 -12 /cwt. The SDR will act as buffer. It can take in product and react to changes in markets in a proactive manner. We are now, as an industry, forced to be reactive to the markets and this is NOT working. Unless dairy becomes proactive via the SDR it will continue the wild roller coaster and destructive ride it is on now. SDR will be operated as a stand alone enterprise. If SDR makes money it will be allowed to keep it and if it operates at a loss that money will have to be replaced by NMPF from its cash reserve. 30 days of national consumption will be the base amount at which the SDR will be stocked at. That will act as the strategic reserve. Once fully operational it will not be in the need of direct government funding.

Continue testing, removal and compensation of diseased cattle. This will demonstrate that the dairy industry is serious about providing America with the highest quality dairy products that can be provided. The on going cost of maintaining this program will be minimal. Do not underestimate the value of this! Once these problems are solved we must not become complacent!

This program would become operational at the end of the four year diseased cattle removal program. It will take 2-4 years to get the federal milk marketing orders reworked to include the SDR. The 40 cent assessment will stay in place until all loan guarantees are repaid. Once loans are repaid the assessment will continue until enough money is in the reserve so farmers will never have to ask for loan guarantees again. Have enough cash on hand to purchase the milk equivalent of 1-2 % of national production. Estimates of this are approximately one billion dollars. Once accomplished the assessment will be reduced to a nominal figure of 10 cents /cwt. However, authority to raise the assessment as dictated by events would remain a part of the SDR. The industry will,now, be proactive and independent. This will end the MILC program which will be a direct saving to the federal government. Based on the numbers provided it is estimated that the loan guarantees would be almost fully repaid by the time the reworked Federal Milk Marketing Orders, including the SDR would be instituted.

SUMMARY. The SDR will provide stability to markets and to farmers. It transforms the CCC from the market of last resort into a dynamic part of the market. The American dairy markets are not flexible enough to compete on the world market. With the CCC being a market of last choice and no tangible mechanism to deal with changes in supply. The American dairy farmer is at a significant disadvantage. The SDR will absorb shifts in supply in an orderly manner. The SDR will act as a shock absorber to changes in the mechanics of the free market without altering them. It will become a part of the free market, instead of it just being a spectator. It is fair to all farmers big or small and it treats them the same whether they milk cows in New York or Alaska. Once fully implemented it will save the goverment billions of dollars from the elmination of the MILC program, which at times is very costly. Clear example 2009. It also does not discourage expansion of farms and it does not penalize any person trying to enter the industry for the first time. These items are very important in future years as this country is always going to need farmers. New farmers must not be put at further disadvantage when trying to enter the industry. Example is trying to enter the dairy industry in Canada, with the purchase of quota. It is very difficult. This program will fix the acute, mid term and long term problems of the dairy industry. It also uses the tools we have now available to us as an industry, just uses them in a proactive manner. The dairy industry has NEVER had a way to abosrb shifts in supply. The SDR will allow dairy to operate in the free market without manipulating it.

We as a country have the strategic oil reserve, which consists of crude oil strored for 90 days of domestic consumption. For the sole purpose of mitiagating sudden changes in the world oil markets. This same, somewhat modified, approach will be used ,effectively, with the SDR. The difference being that the SDR would be a dynamic part of the market where as the oil reserve is not. It will also allow the dairy industry to become independent from looking to Washington to solve its problems. Something that it has tried unsucecssfully for almost 30 years.

Without this, the industry is coming very close to becoming destablized which costs will be catasrtophic.

Sincerely

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