

**Volatility Subcommittee Report
to the Dairy Industry Advisory
Committee
September 20, 2010**

Subcommittee Members

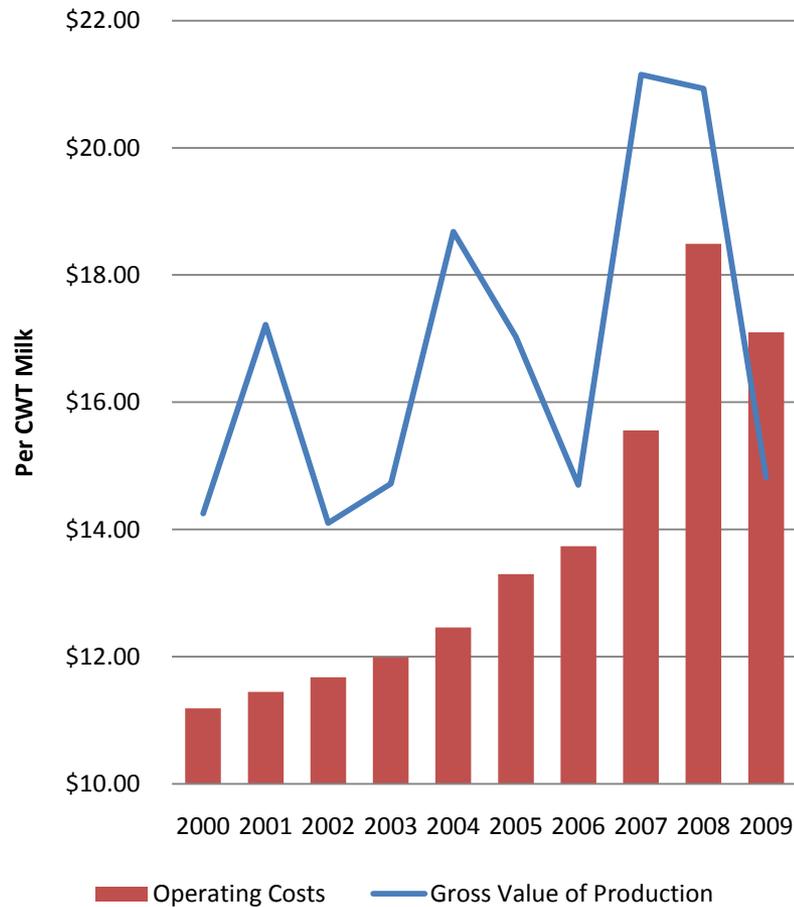
- Jay Bryant, Chair
- Tim den Dulk
- Debora Erb
- Bob Schupper
- Sue Taylor

Definition: Volatility of Concern

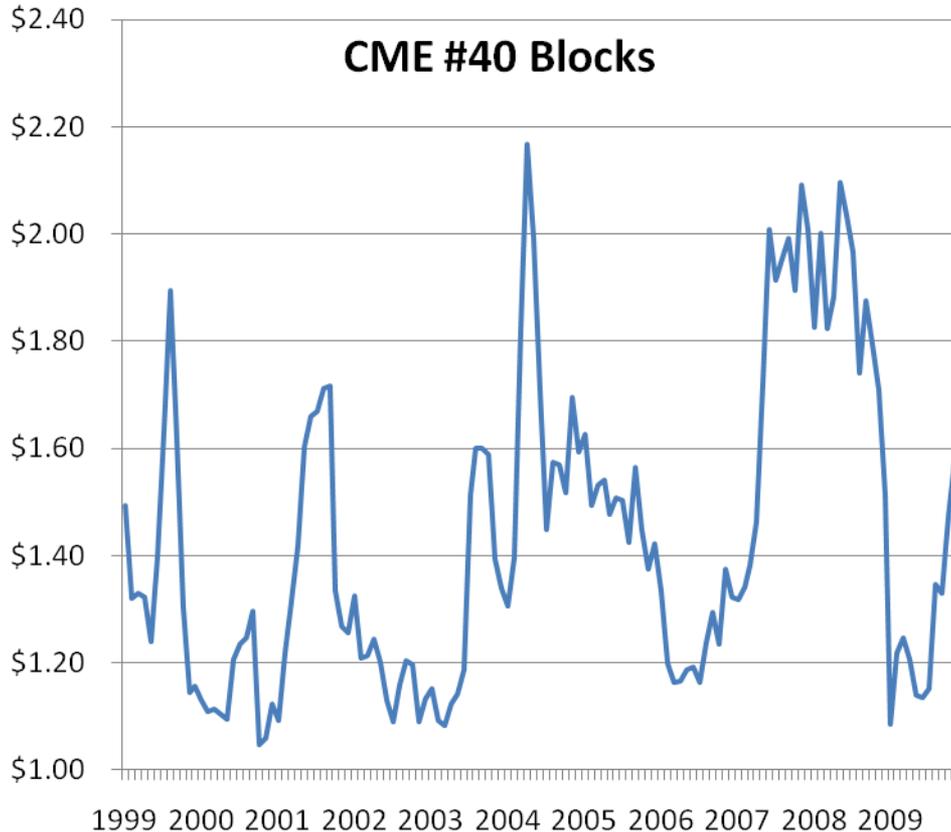
- The frequent unpredictable fluctuations in prices that result in detrimental impacts on margins in the supply and demand chain. This chain includes producers, manufacturers and fluid processors, marketers (retailers, food service establishments, and food manufacturers) and consumers.

Farm Volatility Concerns

- Farm margin volatility of greater concern than absolute price level

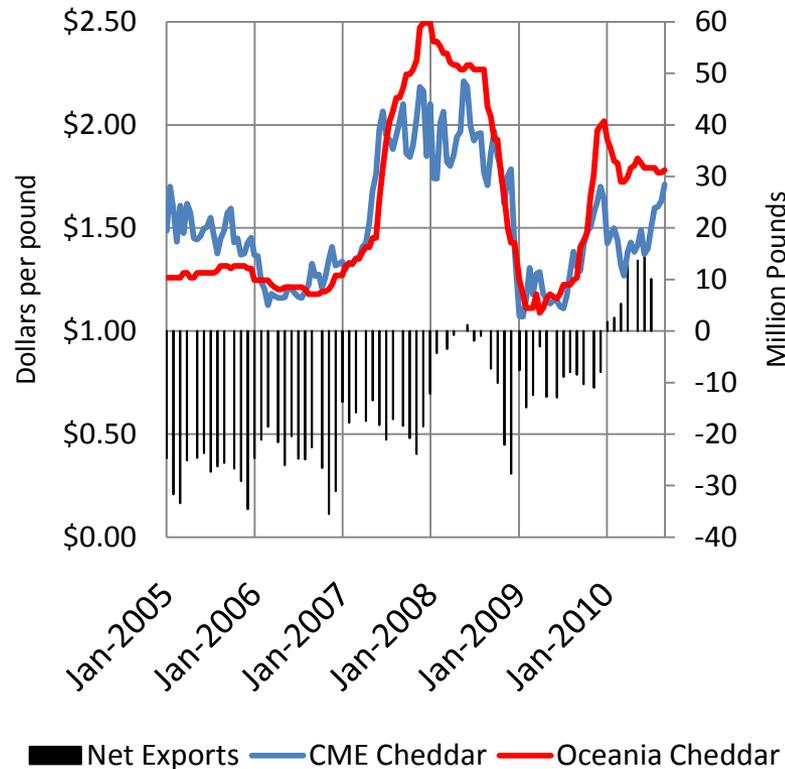


Manufacturer & Downstream Market Volatility Concerns



- Product price volatility of concern in downstream markets.

Outlook



- Volatility will remain at some level due to:
 - the biological nature of the production systems,
 - the stickiness in supply and demand adjustments,
 - the interplay with international markets, and
 - budgetary considerations that constrain the implementation of price supports at levels that significantly reduce volatility

Proposed Policy Parameters

- Policy solutions that are developed to address the farm margin volatility problem not be detrimental to the ability to manage the finished product price risk.
- Policy solutions should not significantly intrude upon the market-driven relative competitive position of dairymen vis-a-vis other dairymen.
- Policy solutions should not result in a retraction in markets for U.S. products by discouraging exports and encouraging imports.

Recommendation:

Farm Savings Accounts

- Amend the tax laws to provide for farm savings accounts
 - No limits on the dollars deferred per year.
 - Provide government match on contributions up to \$20,000 contributed on annual basis.
 - Require money to remain in account a minimum of six months and allow withdrawal at account-holder's discretion thereafter.
 - Taxes are payable upon withdrawal from the account.
- Benefits:
 - Tool for dairy farmers to manage margin volatility.
 - Reduction in tax-avoidance driven investments in good years that contributes to deeper trough.

Recommendation:

Risk Management Margin LOC

- Provide risk management margin lines of credit to cooperatives and proprietary processors with valid risk management programs in order to facilitate risk management.
- Although the subcommittee does not yet have an opinion regarding the lending mechanism, implementing such margin lines of credit through commercial credit guarantees rather than through direct lending warrants further consideration.
- Benefits:
 - Facilitates programs that overcome deterrents to using risk management tools, such as
 - minimum contract sizes that exceed some individual farm's production,
 - complexity, and
 - margin requirements
 - Additional liquidity in futures markets improves ability for downstream market participants to manage their price risk, preserving demand.

Further Study Required: Supply Management

- A properly structured supply management program could reduce volatility.
- An improperly structured supply management plan could contribute to increased volatility.
- Need to better understanding the modeling results and the potential long term negative impacts.

Further Study Required: Supply Management Concerns

- Stifling investment in processing and manufacturing plants and new product development due to uncertainty of production levels.
- Potential to retard development of milk supplies in regions that are deficit, even if supply and demand conditions support development of additional milk supplies in that region.
- Potential that proposals will introduce increased volatility if intervention lags result in corrective action occurring concurrently with or subsequent to market correction.
- Devaluation of livestock by decreasing cattle demand due to reductions in expansion cattle market.
- Inhibiting the farmers' ability to manage risk by increasing production when needed.
- The potential of increasing imports and decreasing exports.
- The potential to incent market disruptive behaviors at the end of measurement periods, such as:
 - Dumping skim
 - Moving cows
 - Reduced marketings
- The unintended consequence of driving a race for the base mentality, incenting producers to increase production during periods in which penalties are not incurred.
- The potential that supply management inhibits growth of dairies to the scale necessary to address environmental and global competitiveness requirements.
- The potential that supply management may increase volatility by forcing greater uniformity in production decision making than exists today.
- Taken as a whole, the subcommittee is concerned that supply management is 180 degrees in the opposite direction of the growth-driven strategies that most industries undertake to create a dynamic and thriving industry.

Further Study Required: Programs that Address Rural Development Goals without Distorting Markets

- Segment market issues from social issues.
- Rural development and farmland preservation goals may be better addressed through green payments or other mechanisms that are less market intrusive and are not considered trade distorting under world trade agreements.

Further Study Required: Modification of Existing Policies

- Milk Pricing Policy
- Dairy Price Support Program & MILC - - replacement with margin protection