

Milk Producers Council

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MPC FRIDAY MARKET UPDATE

CHICAGO MERCANTILE EXCHANGE

Blocks +\$.0250 \$1.6000
Barrels +\$.0575 \$1.5000

CHICAGO AA BUTTER

Weekly Change N.C. \$1.5250
Weekly Average N.C. \$1.5250

NON-FAT DRY MILK

Week Ending 11/06& 11/07
Calif. Plants \$1.0919 8,709,168
NASS Plants \$1.1115 11,457,952

Weekly Average

Blocks +\$.0150 \$1.5860
Barrels -\$.0200 \$1.4540

DRY WHEY

WEST MSTLY AVG w/e 11/12/09 \$.3675
NASS w/e 11/07/09 \$.3468

CHEESE MARKET COMMENTS: It was a relatively quiet week on the CME this week, with prices for blocks increasing on Monday and Friday, and barrels added a nifty \$.0575 on Friday. The block/barrel price gap closed to \$.10 per lb. USDA's report on lower milk production in October (released after the market closed on Wednesday) could account for Friday's price increases because there was no other news this week of particular importance to the cheese market. The weakness in barrel prices is thought to be a natural response to relatively slow sales, is not thought to be a cause of great concern, and is not carried forward into wholesale prices. Prices reported to NASS by manufacturers for sales made last week had barrel prices about a half-cent **above** blocks, where they have been for several weeks. Cheese production continues to be running about even with the same period last year, and about even with total cheese sales. That prediction made by the head of a major producer cooperative earlier this year that block prices could reach \$1.70 per lb by fall, seemed at the time to be merely wishful thinking, but now looks to be a real possibility.

BUTTER MARKET COMMENTS: Butter prices were steady all week on the CME, as wholesale prices reported by NASS begin to catch up to the spot market. *Dairy Market News* (DMN) reporters have been receiving reports of heavy retailer promotions around the country and orders from food service buyers are stronger than recent months; stronger than expected. International buyers are said to continue to inquire about prices and product availability for next year. Heavy cream usage for holiday-related products is affecting butter production; that, and the lower amount of milk being produced could mean that U.S. butter production in October and November will be as low as it's been in six or more years. Be thoughtful, U.S. sellers, about making commitments you may later regret; take a look at the prices for anhydrous milkfat that were bid on Fonterra's internet auction for shipment from New Zealand from January through April 2010 - \$2.15 per lb, and up.

POWDER MARKET COMMENTS: Production of nonfat powder continues to trend lower in the U.S., and supplies are reported to be tight. Milk and condensed skim for higher-paying usages continues to pull raw product away from driers. The major price series were lower last week; DMN reports that buyers are resisting prices towards the high end of the reported price ranges. Their reading last week: light offerings were meeting light demands, although some Western powder was being used to fill orders from the central region. Spot prices on the CME for Grade A and Extra Grade non-fat powder are \$1.40 per lb.

WHEY PRODUCTS MARKET COMMENTS: The demand for whey proteins continues to be very good. Exports remain strong, prices are rising, and the supply is tight. The average of the West's "mostly" price range rose \$.0075 per lb, the largest weekly increase in a long time. The market for commodity grade whey protein concentrate remains strong and prices continue to rise. The average price this week reached \$.8325 per lb. DMN says production is reported to be falling behind orders because of shortage of raw product or price of raw product. Planning for 2010 contracts is underway and is not going easy because of the difficulty in projecting real needs and possible prices.

FRED DOUMA'S PRICE PROJECTIONS...

Nov 20 Est: Quota cwt. \$ 14.70 Overbase cwt. \$13.00 Cls. 4a cwt. \$12.97 Cls. 4b cwt. \$13.72
Last Week: Quota cwt. \$ 14.56 Overbase cwt. \$12.87 Cls. 4a cwt. \$12.60 Cls. 4b cwt. \$13.66

THE DAIRY PRICE STABILIZATION PROGRAM: BRINGING IT BACK TO BASICS: *(By Rob Vandenhuevel)* Since the Spring of 2007, Milk Producers Council has been publicly advocating for a program that would give dairies an incentive to manage their growth in milk production. The program has been called several things – Refundable Assessment, Growth Management Plan, and Dairy Price Stabilization Program – but the concept remained the same.

The basic idea is that given the system of pooling we have in the U.S. where producers are paid the same for the last gallon of milk produced as the first, dairies have an inherent incentive to produce as much as possible, regardless of the market demand for dairy products. This reality means that anytime we have balance in supply and demand (which results in a profitable price), every dairy across the U.S. has the incentive to produce as much milk as possible to “chase” that profit. And given how quickly our industry can ramp up milk production, the response to profitable prices is an immediate and rapid increase in production. Since we have no effective tool to get supply back in line with demand, we go through month after month of devastating losses, which eventually result in the necessary production decreases that get our milk supply back in line with demand. This drives the milk price back up and starts the whole process over again. That’s the “boom” and “bust” you’ve been feeling over the last ten years, getting progressively worse with each “bust.”

That’s where the Dairy Price Stabilization Program comes in. It’s a tool that our industry can use to maintain a better supply/demand balance. While MPC has spent considerable time and effort presenting the program to groups around the country and writing articles in our newsletter, my worry is that some of our readers still don’t fully understand the basic concept of the program. So in an effort to bring everyone up to speed, I’d like to bring the discussion back to basics and explain the fundamental structure of the program.

First, the program would be governed by a producer board of directors, with the U.S. Secretary of Agriculture having the final say. The Secretary and Board would announce two numbers prior to each quarter:

- An “allowable year-over-year growth” in milk production that any dairy can take advantage of without consequence. *(Cornell University has analyzed the program and determined that under normal circumstances, the program should allow production growth of 1-3 percent without paying any fee.)*
- A “market access fee” that must be paid by any dairy that wishes to exceed the “allowable growth.” *(Cornell University has said that under normal circumstances, the program would work best with a market access fee of \$0.50-\$1.00 per hundredweight, assessed on all that facility’s milk for the first year of an expansion.)* **All the market access fees collected would be distributed to the dairies that did not exceed their “allowable growth.”**

And that’s it. The rest is up to each individual dairy. Under this program, every dairy across the U.S. would ask the same question: *Do I want to expand my share of the market, and pay a market access fee during the first year of my new expanded production? Or do I want to continue with my current share of the market, and collect my portion of the market access fees that are collected?* **It’s that simple.**

This is the point where folks start to ask more questions, and MPC has spent the last two and a half years answering those questions. We’ve posted a number of frequently asked questions on a website started by the groups that have supported the program (www.stabledairies.com). For those of you that want to explore the program further, I’d encourage you to go to that website. But for the rest of you, the program is really that simple. It’s about providing incentives, not government mandates. It maintains the individual choice by each dairyman, but allows our industry to grow in a more rational manner. And it gives our industry a tool to respond to sudden drops in market demand without putting our producer sector through another 2009, with equity losses to the tune of \$1 billion per month for much of the year.

NOW FOR A LITTLE MORE DETAIL: HOW TO STRUCTURE THE MARKET ACCESS FEE: *(By Rob Vandenheuvel)* The last article laid out the basics, so now I'd like to delve into a little more detail. One of the most debated details is the structure of the market access fee. But first, a little history.

Earlier this year, the Holstein Association unveiled the "Dairy Price Stabilization Program." The proposal was virtually identical to the Growth Management Plan that MPC had been promoting, charging a market access fee on dairies that are expanding and distributing those fees to the dairies that are not expanding.

That program was designed to charge a market access fee on all the milk produced by an expanding facility for the first year of a new expansion. The program was structured that way because it allows the program to maintain a lower market access fee. If the fee were charged only to the additional milk that is added during an expansion (or as some have called it, the "new milk"), the fee would have to be much higher in order to have the same effect. While that may not mean much to a dairy that is adding a few cows, it's a major problem for a new entry into the industry or a father trying to get the next generation into the business, since all of the milk from a new operation would be "new milk" and would have to pay the high fee for the first year.

However, in September the Holstein Association's board voted to change their idea to exactly that – a fee on "new milk" only. They voted to structure their program with a \$6-\$9 per hundredweight market access fee, payable on the milk produced over your "base" or "allowable year-over-year growth."

This was a change that MPC simply could not support. MPC has always maintained that a program that charges a new dairy with a market access fee that high would put the industry in a straitjacket, preventing the next generation from entering the industry. How could anyone start a dairy and budget for a \$6-\$9 market access fee on all their milk for the first year? The Holstein Association has made an "exception" to address this – their current plan allows a new producer to spread that massive payment out over two years. But the fact remains that this is an enormous cost that will greatly restrict our ability to get the next generation into the dairy business and will stifle our industry's future growth.

Further, a program structured that way has no chance of broad political support. The industry and Congress is simply not going to stand by and allow a program to be implemented that locks out the next generation of dairy farmers and dramatically suppresses our ability to continue growing as an industry.

The alternative: an option for expanding dairies. In an attempt to compromise, California dairymen Doug Maddox (who was also the President of the Holstein Association when they originally unveiled the Dairy Price Stabilization Program) came up with a simple solution. He proposed that the program set up two market access fees:

- An "all milk" market access fee that would be in the range calculated by Cornell University - \$0.50-\$1.00 per hundredweight; and
- A "new milk" market access fee that would be several times higher than the "all milk" market access fee, but would only apply to the additional milk produced.

Under this type of program, a dairy that wishes to expand its production would be able to pay the lower of these two options. So a dairy that wants to grow incrementally could pay the "new milk" market access fee, which would be at a higher rate, but would only apply to the incremental increase in production. And someone starting a new dairy could pay the "all milk" market access fee, which is applied to all that facility's milk in the first year, but at a much lower rate. And just as before, the dairies that don't expand beyond their 1-3 percent allowable year-over-year growth will get their share of those market access fees that are paid.

That simple compromise completely addresses the concerns MPC and others have about the Holstein Association's latest position. And while the Holstein Association has unfortunately scoffed at the compromise, MPC and the other coalition members have seen the value of the compromise and have supported it. We continue to hold out hope that the Holstein Association will recognize both the policy and political weaknesses of

their proposal and join the rest of the coalition in supporting the compromise.

Some folks have questioned whether a program like this would fit in the global economy we are a part of. The answer is a definite yes. Some of you may have heard summaries of a “Bain Report” being developed. The Innovation Center for U.S. Dairy has teamed up with Bain and Company to take a look at how our industry fits within the global economy, and what our future may look like.

That report, while not yet fully released, indicates that the U.S. is capable of being a “consistent exporter” of dairy products. One of the keys to being a consistent exporter is staying competitive with the rest of the world. If we were to “short” our markets of milk and artificially drive the price of milk higher, we would not be able to be a “consistent exporter.” Want proof? Look at Canada.

We believe that is where the original Holstein Association plan (i.e., the Growth Management Plan) excels and where the current Holstein Association plan falls woefully short. A program that maintains a smaller market access fee and allows continued growth in the industry will allow us to take the extreme “booms” and “busts” out of our milk price, but continue producing for the world market. But a program with a burdensome \$6-\$9 per hundredweight market access fee that stunts much of the growth that occurs in our industry will inevitably leave us short of milk and unable to be a consistent supplier of exportable dairy products. The Holstein Association got it right the first time – we need a program that allows our industry to continue growing, but creates an incentive for dairies to manage that growth.

Producers are not benefiting from having two different proposals out there. It is certainly the hope of MPC and the other groups that support the original Dairy Price Stabilization Program that the Holstein Association will recognize that their original proposal – with the compromise mentioned above – is the winning strategy.

The opponents of our program love seeing our coalition split. They prey on the confusion that exists because there are two different approaches. They’ve also laid out some very valid criticisms of the current Holstein Association plan, such as the recent American Farm Bureau Federation’s report that pointed out some of the major concerns with a program that greatly stifles production growth. These opponents paint “supply management” with a broad brush. Criticisms they levy against the current Holstein Association plan get unfairly applied to the original plan, even though most of their concerns are eliminated by the way the original plan was structured with lower market access fees.

We’ve laid out the reasons why the current Holstein Association plan simply doesn’t work, and the crazy thing is that at one point, the Holstein Association agreed. When the Holstein Association unveiled their original plan, they included some “frequently asked questions” on their website, and one of the questions asked why the program applies the market access fee to all the milk of an expanding facility rather than just the “new milk.” The answer on their website was pretty close to the comments I gave above.

Our industry is at a crossroads, and we have an opportunity to make positive changes. We need to make sure those changes improve our industry, not inhibit it. The original Dairy Price Stabilization Program is the improvement we need and MPC and the other coalition partners will continue to work hard to promote it, with or without the Holstein Association.