

## HEADLINES

### DAIRY MEMBER EDITION!

The "Foundation for the Future" dairy policy proposals - developed by the National Milk Producers Federation and intended to help create a more stable, viable and prosperous dairy industry environment – are being introduced to dairy producers across the country.

This special edition of HEADLINES is intended to provide Land O'Lakes dairy members with a top-line view of the proposals, as well as to generate member feedback.

Notably, five Land O'Lakes representatives have been involved in the NMPF effort including:

- Board Chairman Pete Kappelman, who serves on the NMPF Board and on its Dairy Producer Income Protection Program committee;
- Land O'Lakes President and CEO Chris Policinski, a member of the NMPF Board;
- Land O'Lakes Board Dairy Committee Chair Tim Wakefield, who serves on the NMPF Board;
- Land O'Lakes Board member Cornell Kasbergen, second vice chair of the NMPF Board and a member of its Dairy Market Stabilization Committee; and
- Land O'Lakes Director of Milk Supply Jim Sleper, serves on NMPF's Federal Milk Marketing Order Reform committee.

These representatives give Land O'Lakes and its members strong representation in NMPF dairy policy deliberations.

#### Land O'Lakes Position on Dairy Policy

Land O'Lakes goals for a new national dairy policy were determined by the Board's Dairy Committee and are consistent with Policies and Resolutions approved by members at the 2010 Annual Meeting. Those criteria, pursued by our representatives during NMPF deliberations, specified that the policy:

- Be market-oriented to allow for growth in dairy, both domestically and internationally;
- Reduce volatility and create stability across the dairy industry (not necessarily price enhancing);
- Allow producers to decide how much volatility they want;

- Be global in nature and consider the impact on imports and exports (i.e. consistent with World Trade Organization rules);
- Minimize government involvement; and
- Be national in scope without disadvantaging any one region.

#### The Program and the Process

The main elements of the "Foundation for the Future" proposal (which are outlined in this issue of HEADLINES) are:

- A Dairy Producer Income Protection Program;
- Federal Milk Marketing Order Reform; and
- A Dairy Market Stabilization Program

While NMPF has announced, and is gathering feedback and working to build support for, "Foundation for the Future," it is important to understand that implementation of a new dairy policy will take a long time. The NMPF Board expects to vote on the proposals in June, with further revisions as needed. It is likely that the proposals will not take effect until the next Farm Bill is signed into law. Keeping our momentum during this deliberation process will require a unified dairy industry, and producer input will be essential to building the broad base of support. With that in mind, the basic elements of "Foundation for the Future" have been a key topic of discussion at a recent Land O'Lakes Board meeting in Washington, D.C., as well as several dairy conferences, including the Western United Dairymen annual meeting and the 2010 Wisconsin Dairy Policy conference.

In addition, Land O'Lakes is working with elected dairy leaders to gather input and recommendations to ensure member views are represented. As that process moves forward, we urge members seeking more information or wishing to share their views on the "Foundation for the Future" to communicate with their local unit representatives, delegates, local board director or milk procurement specialist. In addition, feedback can be provided to the Land O'Lakes representatives serving on NMPF's board by sending an e-mail to the Land O'Lakes Membership e-mail address at: [membership@landolakes.com](mailto:membership@landolakes.com).

The three main initiatives are described in this issue of HEADLINES. The latest edition of growingtogether™ magazine ([www.landolakesinc.com](http://www.landolakesinc.com)) also includes an article on "Foundation for the Future" and detailed information can be accessed on the NMPF website at [www.nmpf.org](http://www.nmpf.org).

## Dairy Producer Income Protection Program

The Dairy Producer Income Protection Program proposal focuses on helping producers stabilize or protect their income during periods of low margins - typically when either milk prices fall or feed costs rise (or both). The NMPF proposals would enable producers to protect or insure their margin (milk price less feed cost) by enrolling in a margin insurance/protection program. Producers would have an opportunity to sign up for fully subsidized "margin insurance" that will insure a fixed margin for the full duration of the farm bill—typically a multiple year law. The proposed program would be voluntary, with no production, size, payment or regional restrictions. The margin protection would be considered catastrophic coverage and producers would need additional protections to manage margin risk.

### *Proposal Specifics*

Each participating producer would have an historical milk production base (milk base) assigned to their farm. A fixed percentage (i.e., an amount less than 100 percent) of this milk base would be eligible for coverage under the margin insurance program. This milk base would not be transferrable from one farm to another. New producers will be allowed to participate in the margin program, but only under specific conditions.

The USDA may offer an optional, additional (and also voluntary) supplemental insurance program that would have a cost attached to it based on the level of margin protection chosen by the producer. All producers would have the option to sign up for this program, which would be provided and subsidized by the USDA. The cost of the supplemental insurance to the producer would increase as the level of margin coverage increases. Said another way, the USDA subsidy will decrease as the level of coverage chosen by the producer increases. Producers would have up to one year to decide whether to enroll in supplemental margin insurance. Producers, of course, will still have the option of managing their risk exposure by utilizing the hedging and risk management tools currently available.

NMPF has worked closely with several university and industry experts (including Steve Watrin, Land O'Lakes manager of dairy planning), designing the insurance program's parameters to ensure they reflect realistic margin levels necessary to protect dairy farmers' income and equity. It is important to keep in mind that the margin insurance program is intended to enable producers to cover their operating expenses and better maintain their farm equity during financially challenging periods. However, it does not assure profitability or encourage production beyond market needs.

Operationally, the USDA would calculate the actual margins experienced by producers on a monthly basis and, when actual margins were less than the fixed margin insurance levels, the USDA would make payments (quarterly) to participating dairy farmers.

Again, the overarching goal of the proposed program is to help dairy farmers weather low margins by providing low- or no-cost margin insurance. The program would have minimal impact on market prices, which would continue to be determined primarily by the dynamics of milk supply and demand.

## Federal Milk Marketing Order Reform

The goal of the NMPF Federal Milk Marketing Order Reform subcommittee was to develop proposals for a milk pricing system that compensates producers fairly, reduces volatility and creates a more dynamic dairy industry.

Over the past several years many industry participants (from producers to processors) have been critical of federal orders, specifically as it relates to the procedures for updating product price formulas—the method used to establish the classified prices in the federal orders. The procedure for updating manufacturing or "make allowances" (an integral part of product price formulas) has proven to be divisive, with many market participants agreeing that the industry needs to consider other ways to price milk.

### *Proposal Specifics*

The NMPF subcommittee has agreed that federal orders should be maintained – that they should be amended not ended. The subcommittee understands that the class I (fluid) market is still the highest valued market and their proposals are intended to ensure that dairy farmers continue to share the value of that market. Two primary ideas for change have emerged from the subcommittee's work:

- **Discontinue the use of product price formulas to determine classified prices, and**
- **Replace product price formulas with a competitive price series.**

Several years ago, federal orders used a competitive price series, the Minnesota-Wisconsin price, to calculate classified prices. The M-W was based on a survey of manufacturing plants in Minnesota and Wisconsin that competed for Grade B milk to use in their dairy manufacturing plants. This competitively-determined price was used to establish the basis for classified prices.

The proposal under consideration would consist of a similar survey of prices paid for milk by cheese plants. The resulting competitive price series will likely be implemented in the same way that the M-W was structured, incorporating an update pricing factor based on a smaller sample of plants.

## Dairy Market Stabilization Program (DMSP)

U.S. dairy farmers have experienced drastic swings in farm milk prices, feed costs and their resulting margins in recent years. In addition, factors outside the control of dairy farmers (such as the domestic and global economic environment, exchange rates and export policies here and abroad) have had major impacts on dairy farmers' margins.

It's in this market context that the DMSP was developed. It recognizes that production levels (which producers can control) can impact and help stabilize markets and margins. The goal of the DMSP (proposed as part of the "Foundation for the Future") is to prevent extreme swings in producers' margins by sending a strong signal to all dairy farmers to reduce their milk production when the market is marginally over supplied. The signal would be sent through the price of the percentage of milk (the marginal milk) that the U.S. milk market is oversupplied—typically no more than 1 to 5 percent. The price for this small portion of milk production would likely be zero. Producers would choose whether or not to produce this marginal milk volume.

### *Proposal Specifics*

The DMSP would be a mandatory program administered by the USDA, which would implement the program based on a series of predetermined requirements that would be triggered only when producers' margins fall to specified levels. The DMSP, when activated, is designed to prevent extreme swings in producers' margins by signaling to dairy farmers to reduce their milk production to realign milk supply with product demand. It does this by eliminating payment to producers for a portion of milk within the producer's historical milk base when margins fall to specified levels.

*Note: Under the DMSP proposal, a producer's base will be a rolling average of the three most recent month's milk marketings. In this way, a producer can grow his base without experiencing significant penalty. Producers may also have an option to select the same month in the previous year as their milk base.*

The program is triggered when the national average margin falls below the margin trigger level for two months, and remains active until the national margin exceeds the margin trigger level for two months.

Recognizing that the U.S. dairy industry operates in a global market, the DMSP triggering criteria would not apply if the U.S. average price of cheese or skim milk powder significantly exceeds the world price for these two products. Similarly, if margins remain at or above the levels pre-determined to allow dairy farmers to remain financially solvent, the DMSP would not activate.

Here's how the DMSP would work ... keeping in mind that specific criteria to trigger the program are still under consideration. When the national margin narrows to a specific dollar level (yet to be determined), any milk over 99 percent of a producer's historical base milk will receive no (producer) payment. This effectively makes the price \$0 for the last 1 percent of a producer's base milk, as well as for any milk in excess of the producer's milk base. If in the next month the margin shrinks more, any milk over 98 percent of a producer's base milk will receive no payment. Until the national margin exceeds the triggering criteria for two consecutive months, the DMSP would remain in effect.

Under DMSP, all of a producer's milk would still get picked up and processed, but the payment for the 1 percent, 2 percent, etc., would go directly to the USDA instead of the producer. This payment shift would signal dairy producers that the market is oversupplied. The funds collected by the USDA would be used to stimulate the demand for dairy products, such as purchasing dairy products for food assistance programs, enhancing school nutrition programs or promoting the export of U.S. dairy products.

## Summary

The process of changing federal dairy policy resembles a marathon more than a short sprint. The marathon has begun and getting to the finish line will take a lot more discussion and input from dairy farmers across the country, including Land O'Lakes producer members. Land O'Lakes supports the concepts and overall direction of the proposals included in the "Foundation for the Future" proposals. Clearly, the proposals raise many questions that merit comprehensive discussion during this marathon.

These proposals represent major changes in the way the federal government supports the U.S. dairy industry. For example, federal orders were conceived during the depression era—nearly 80 years ago. The price support program was devised post WWII—roughly 70 years ago. Clearly, the structure, scale and scope of dairy markets have changed drastically since these two policies came into being. New market challenges have arisen requiring the industry to reconsider how to best support dairy farmers and dairy businesses in a fast-changing, global market.

Dairy farmers must have time to understand the reasoning behind changing these long-standing programs that have effectively served the dairy industry for many years. U.S. House of Representatives Agriculture Committee Chairman Collin Peterson, D-Minn., has stated: "...we all agree that the safety net for dairy farmers is not working and we need to consider new ideas that could provide better security for our nation's dairy producers."

This issue of HEADLINES continues the process of keeping dairy members informed of the proposals. Six meetings for elected dairy members (unit delegates and alternates) offer an opportunity for more discussion and input. These are major changes and we need your best thoughts. If, after reading through this brief summary of the proposals, you have questions or concerns, please contact your local delegates or your local milk supply field staff. More opportunities for input will include the Mid-Year Leadership meeting in late summer and fall regional meetings.

<u>REGION</u>	<u>DATE</u>	<u>LOCATION</u>
51-52-53	June 10	Harrisburg, Pa.
65	June 15	Fairmont, Minn.
66	June 16	Alexandria, Minn.
68	June 17	Rothschild, Wis.
80	June 21	Corning, Calif.
80	June 22	Tulare, Calif.

The entire U.S. dairy industry has a stake in the future of dairy policy. The proposals in the "Foundation for the Future" will spark discussions across the industry and ideally result in a collaborative, unified industry-wide approach to effectively address this policy challenge.