



## Milk Producers Council

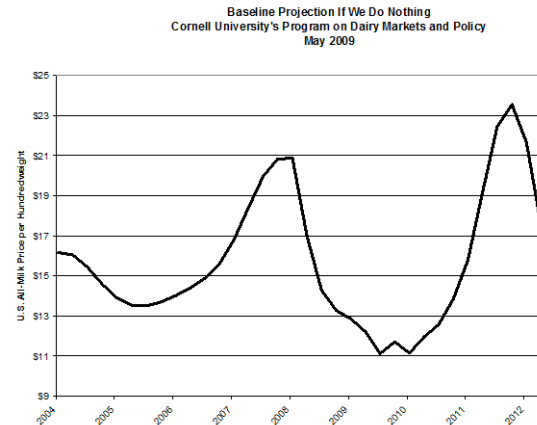
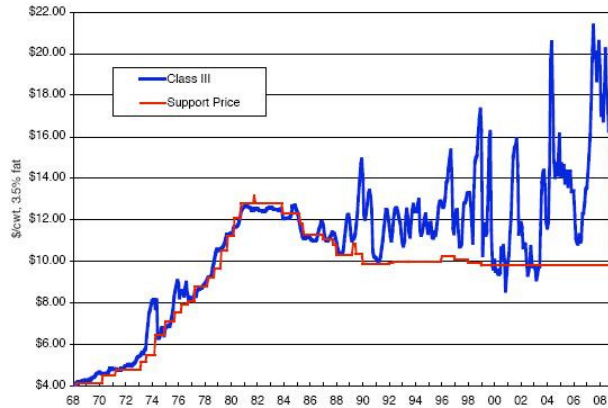
"Serving the Dairy Industry for more than 60 Years"

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### Cornell University Report Highlights the Continuing Threat of Milk Price Volatility

By Rob Vandenheuvel, MPC General Manager

This week, Cornell University's Program on Dairy Markets and Policy released the full report on their analysis of the Growth Management Plan. Drs. Mark Stephenson Nicholson included an expansive discussion of milk price volatility and how it has gotten dramatically worse with each boom/bust cycle. The readers of this newsletter before, but it bears repeating: **volatility is undoubtedly the single largest threat to this industry.** For those who want to read the full report, it can be found at: <http://dairy.cornell.edu>.



Shown above is a chart taken from Cornell's report, showing how the Federal Order Class III price (cheese) has moved over the past forty years. As you can see, we have volatility for a couple of decades, but the recent "peaks" and "valleys" have gotten dramatically worse.

Also included in the report is this sobering chart above showing what the Cornell University model forecasts will happen to the U.S. all-milk price over the next five years if nothing is done.

**What does all this mean?** This year is shaping up to be the worst year ever experienced by those currently in the dairy business. There's no way to sugarcoat it – the farmers will collectively take billions of dollars in equity built up over the decades they've been in business, and convert it into bank loans.

There will be some producers that decide to get out of the industry – either by choice or by force. And while that is extremely unfortunate, the real question I'm asking is at those who are staying in: **With the massive boom/bust cycles that have become common in this industry, how do you plan to build your equity back up?** / banks feeling the pain in this wreck, are they going to be there for you the next time to get you through that wreck?

Sure, there will be profitable times once we come out of this wreck, and Cornell's model predicts that as well. But are the good times going to be long enough to make massive hemorrhaging of equity that is currently taking place? Are your pockets really deep enough to not only survive this wreck, but survive the next one as well?

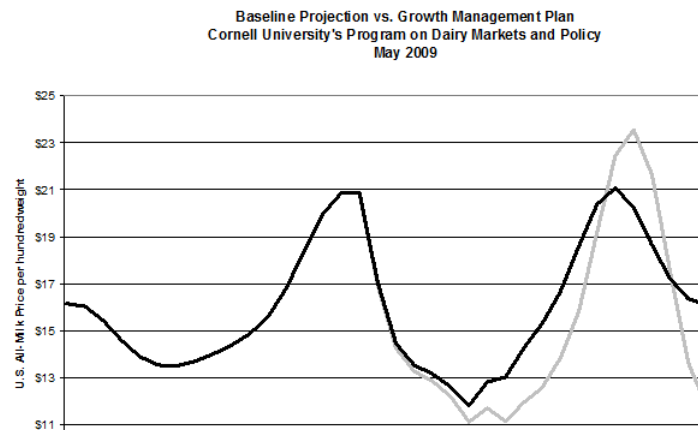
It doesn't take a complex formula to understand why we have this volatility. Our industry is hard-wired to overproduce. Not only do U.S. producers have some of the best technology, and the most efficient operations in the world, but we've also got every incentive to maximize those resources and produce as much milk as we can, and dairy farming has any level of profitability. **Simply put, individual dairies in our industry have every ability – and every incentive – to exceed market demand for products, quickly turning any possible supply/demand balance (and profitable price) into a surplus (with a plummeting price).**

**It doesn't have to be like this.** As our readers know, MPC has been talking with industry groups for more than two years about the benefits of the Growth Management Plan. Despite what critics may say, this is **not** a supply management program – at least not the kind of program that we've become familiar with, such as the quota systems in Europe. **It does absolutely nothing to dictate how many cows you milk, how much milk you produce, what you feed your cows, whether or not you use sexed semen, or any other business decision you make on your farm.** Instead, the Growth Management Plan is a uniquely-American concept that creates a financial incentive for dairies to pay attention to the amount of milk you produce.

The chart to the right shows what Cornell University's model forecasts the U.S. all-milk price would be if we had the Growth Management Plan in place. Granted, we're in a hole that the Growth Management Plan can't get us out of overnight. But look at the next wreck predicted to be in 2012-2013. **Which line would you rather invest your hard-earned equity in?**

The U.S. dairy industry is a highly regulated industry, and anyone who says something like "the markets will fix this problem" is not living in reality. Some people will tell you that this is the "market" getting rid of the "less efficient dairymen." They will argue that the industry is stronger coming out of these wrecks. To put it bluntly, that logic is just plain wrong. The wreck we are currently going through has almost nothing to do with "efficiency" on the farm. After going through the volatility we've seen in the past couple decades, the "inefficient" dairymen are long gone. This wreck is about who can bleed equity the longest? Who has the massive amounts of family money behind him? And for those that don't, tough luck.

This is not about "market signals" to producers. In fact, the Growth Management Plan would actually send more market-oriented signals back to individual producers than the current



industry. How do I make this claim? Let me put it this way – in virtually any other industry, a new entry into an established market would have to compete directly with its competition for a piece of that market. Usually, that new entrant competes by having a lower price or better quality to earn that market share. Once that market share is established, that new business merely needs to stay even with its competitors in order to maintain his customers.

Contrast that with the dairy industry, where anyone can set up shop and as long as they can find a cooperative that will pick up their milk, they are guaranteed an equal market revenues – **on day one**. What if the market is theoretically “full” and that new production is actually surplus milk that is ultimately sold to the government for \$9 hundredweight? That cost is spread out over all producers in the pool while the new producer gets the full blend price, just like his neighbor.

So how does the GMP change that? Under the GMP, the new entry would still be able to set up a dairy just as they can now. But during the first year of production, they need to pay a “market access fee” – their cost for bringing new production to the market. That fee would be distributed to all the dairies that hold their production in check to allow the market room to absorb the additional production. And the same concept applies for dairies that expand their production.

For the dairies that hold their production, their benefit is an additional revenue stream (their share of the market access fees) and stability in the market. For new dairies that wish to expand, they have the benefit of growing in a stable and profitable industry, and once they have established their new production for a year, they no longer have to pay a market access fee. A win-win.

So for those “free-marketers” who oppose the Growth Management Plan on the grounds that it is “more market-distorting government,” I would strongly suggest that, **it is the Growth Management Plan that gets us closer to real market signals than currently exists in the dairy industry.**

As I've reported in this newsletter, the Holstein Association has developed the “Dairy Price Stabilization Program” (DPSP) – a concept identical to the Growth Management Plan. The Dairy Producers Council is supporting the Holstein Association in promoting their concept around the country. For more information on the DPSP, and a current list of supporters, visit <http://www.holsteinusa.com/association/dairyprice.html>.

I have come across a few opponents of this plan (although I would point out that a vast majority of those opponents are individuals who own *zero* cows...it's a lot easier to oppose if your livelihood is not dependant on the stability of this industry). To those opponents, I would extend a challenge to you: **What are you proposing we do?** Give us your professional opinion that this volatility will continue as long as we have the perverse incentives to grow, grow, grow in our industry regardless of market demand. **Are you proposing we deal with this?** Is the current “supply management” we have (*a.k.a. enough bankrupt dairy farmers to finally get production in line with demand*) a preferred option? And if you are a dairyman who takes that view, are you that confident that you will be able to hemorrhage equity longer than your neighbors? How long will it be before your number is called?

It's easy to be against something. It takes courage to be for something. This is the time for our industry to show courage. Courage to be willing to explore a new direction, asking for anyone to embrace Canada or Europe's flawed programs. We're asking producers to embrace a uniquely-American proposal that would allow us to – in the words of the Holstein Association President Doug Maddox – “produce for the market instead of trying to market all we can produce.”

This plan is being considered by a number of groups across the country. As I wrote a few weeks ago, DFA has set up a task force and is exploring long-term solutions including this proposal. So is the National Milk Producers Federation. If your co-op or trade association has taken no position on the Dairy Price Support Program, call your members. Call your co-op and trade association managers. Ask them why they've taken no position. If they are opposed, ask them why, and what their plan is. **The discussion is now, and dairy producers across the country should be demanding that their leadership be engaged in this debate.**

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