Foundation for the Future

A new direction for U.S. dairy policy

What is Foundation for the Future?

• New roadmap for U.S. dairy policy
• Comprehensive package of proposed dairy policy programs for 2012 Farm Bill
• Focuses on margin protection and market stabilization vs. just price
• Offers protection, stability and growth
What is Foundation for the Future’s approach?

1. Replace federal dairy support programs
2. Launch Dairy Producer Margin Protection Program
3. Reform milk pricing set by FMMO
4. Establish Dairy Market Stabilization Program

How will Foundation for the Future revise support programs?

- Discontinue Dairy Product Price Support Program
  - U.S. has become world’s balancing plant
  - Reduces demand for U.S. products
  - Dampens ability to export
  - Stifles product innovation
  - Undercuts U.S. producers, supports global markets
  - Sets outdated price levels
How will Foundation for the Future revise support programs?

• Eliminate Milk Income Loss Contract Program
  - Offers inconsistent safety net for producers facing low operating margins
  - Inadequately offsets high feed costs
  - Unable to provide price target to track national milk prices
  - Promotes unequal treatment of producers (size)
Why is MILC inconsistent?

<table>
<thead>
<tr>
<th>Year</th>
<th>MILC Payments</th>
<th>Average Margin</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>$934,213,000</td>
<td>$7.15</td>
</tr>
<tr>
<td>2001</td>
<td>$162,450,000</td>
<td>$9.58</td>
</tr>
<tr>
<td>2002</td>
<td>$1,041,984,000</td>
<td>$6.50</td>
</tr>
<tr>
<td>2003</td>
<td>$942,516,000</td>
<td>$6.72</td>
</tr>
<tr>
<td>2004</td>
<td>$180,810,000</td>
<td>$9.69</td>
</tr>
<tr>
<td>2005</td>
<td>$5,985,000</td>
<td>$9.55</td>
</tr>
<tr>
<td>2006</td>
<td>$663,408,000</td>
<td>$6.70</td>
</tr>
<tr>
<td>2007</td>
<td>$11,520,000</td>
<td>$10.72</td>
</tr>
<tr>
<td>2008</td>
<td>$0</td>
<td>$6.86</td>
</tr>
<tr>
<td>2009</td>
<td>$855,360,000</td>
<td>$3.88</td>
</tr>
</tbody>
</table>

What is the Dairy Producer Margin Protection Program?

- Enables producers to insure their margin
  - Floors producer margins during poor dairy market conditions
    - When milk prices are low
    - When feed costs are exceptionally high
    - When markets collapse
  - Covers 90% of a producer’s milk production history when margin falls below minimum level
What are the DPMPP principles?

• Voluntary
• 2 levels of coverage:
  ▪ Base Plan – program available to all producers at no cost
  ▪ Supplemental Plan – program available to all producers seeking additional/affordable coverage
• Margin guarantees are fixed for Farm Bill duration
• Will not cover new production beyond production history
• Features new measures for calculating margins

What is the new measure for producer margin?

• Margin defined as:
  ▪ All Milk Price – Total Feed Cost Per CWT
• New NMPF-developed feed cost ration includes all cattle (dry cows, hospital cows, replacement heifers, calves)
How is DPMPP milk production history determined?

- Uses highest annual milk production from the 3 years prior to DPMPP implementation
- Prior implementation, new producers without production history use latest monthly data, extrapolated to a full 12 months
- Production history is fixed for duration of Farm Bill
- Production history stays with the farm or farmer; cannot be transferred
- After implementation, only new producers eligible for the program

How does Base Coverage work?

- Addresses catastrophic losses only; rarely triggered
- Guarantees fixed margin for 90% of production history
- Voluntary – opt-in eligibility for all producers
- Margin guarantee fixed at 50% of yearly CBO-projected margin
  - Plus/minus $1 depending on level of CBO projection
How does Supplemental Coverage work?

- Guarantees fixed margin for up to 90% of production history
- Offers higher level of protection (possibly double the protection beyond the Base plan)
- Puts producers in control of their own risk management
  - Lenders look favorably on insurance

How does Supplemental Coverage work?

- Voluntary – opt-in eligibility for all producers
- Requires annual premium payments (like home insurance)
- Net cost to producer depends on:
  - Level of additional guarantee selected
  - Volume of milk production to be protected
How does Supplemental Coverage work?

- If base coverage is $4.00, what would it cost to add another $1.00, $2.00, $3.00 or $4.00 to your base coverage:

<table>
<thead>
<tr>
<th>Additional Protection per cwt.</th>
<th>Premium per cwt.</th>
</tr>
</thead>
<tbody>
<tr>
<td>$1.00</td>
<td>$0.036</td>
</tr>
<tr>
<td>$2.00</td>
<td>$0.155</td>
</tr>
<tr>
<td>$3.00</td>
<td>$0.434</td>
</tr>
<tr>
<td>$4.00</td>
<td>$0.922</td>
</tr>
</tbody>
</table>

The above table is for example purposes only.
Base and Supplemental Protection Example

- 200 cow dairy, 20,576 lbs/cow, 4.1 million lb. production history
- Wants $2.00/cwt supplemental on 90% of production history
- Annual Premium Rate 15.5¢/cwt, $5,669 per year
- 2009 DPMPP Payout:
  - Base Protection = $29,097
  - Supplemental = $55,274
  - Total Paid Out $84,371 or $2.08/cwt.

Why revise FMMOs?

- FFTF evaluating revisions in FMMO system
- Benefits to revisions should include:
  - Discover true market price (competitive pricing)
  - Eliminate end-product pricing formulas, make allowances, yield factors
  - Less price volatility
  - Encourage product innovation
What is Foundation for the Future’s position on FMMOs?

- Maintain basic framework of FMMO system
- Develop competitive pricing system
  - Promotes fair compensation for producers
  - Reduces market volatility
  - Encourages new products resulting in higher returns for dairy producers and manufacturers
  - Creates more dynamic dairy industry

What are the key FMMO revisions?

- Maintain minimum price for Class I price with no change in differentials
  - Using Class I mover - national weighted average of advanced Class III competitive pay prices
- Class III price is competitive pay price, but not a minimum price any longer
Why do we need the Dairy Market Stabilization Program?

- In 2009, producers didn’t overproduce their way to low margins
- Domestic/global price collapsed with global recession
- Low milk prices + high feed costs = LOWEST MARGINS EVER!
- Wait for situation to correct itself, but at producers’ expense

What does the Dairy Market Stabilization Program do?

- Acts as a smoke detector
- Alerts producers when market imbalances between supply and demand occur
- Helps producers adjust milk production to match demand
  - Improves milk prices
  - Improves margins
How does the Dairy Market Stabilization Program work?

• Activates if margin falls below trigger margin for 2 consecutive months
• Gives producers a 30-day window to adjust milk production
• Uses same margin determined monthly for DPMPP
• Calculated on a producer’s milk base:
  ▪ A rolling 3-month average of the most recent milk marketing immediately prior to DMSP implementation
  OR
  ▪ The same month in the previous year

How does the Dairy Market Stabilization Program work?

• $6 for 2 consecutive months
  ▪ Producers paid for 98% of their base milk marketings
  ▪ Maximum reduction is 6% of current milk marketings
• $5 for 2 consecutive months
  ▪ Producers paid for 97% of their base milk marketings
  ▪ Maximum reduction is 7% of current milk marketings
• $4 for 1 month
  ▪ Producers paid for 96% of their base milk marketings
  ▪ Maximum reduction is 8% of current milk marketings
How does the Dairy Market Stabilization Program work?

• Designed to act swiftly, but infrequently
• When applied to scenarios between 2000-2010
  ▪ DMSP would have activated only 5 times
  ▪ In 2009, the longest activation would have lasted 6 months

What are the benefits of the Dairy Market Stabilization Program?

• DMSP covers all producers in all markets
  ▪ No exceptions!
• Allows for production growth
• Reduces margin volatility
• Minimizes government intervention
• Monies used to stimulate demand/consumption domestically and internationally
Examples of how DMSP would work

The following program examples explain how the program is intended to work:

• Scenario:
  • The margin for April and May is below the $6.00 margin trigger level
  • USDA announces DMSP will begin in July
  • The pay price for July is $14.00/cwt.

DMSP Examples (continued)

• Producer A:
  ▪ Base milk marketings 1,000,000 lbs
  ▪ Markets 1,010,000 million pounds in July
  ▪ Paid for 980,000 lbs. (1,000,000 lbs. times 98%)
  ▪ DMSP deduction from his milk check for July:
    • 1,010,000 lbs. minus 980,000 lbs.) = 30,000 lbs
    • 30,000 lbs. X $14.00/cwt. = $4,200 deducted from milk check.
DMSP Examples (continued)

- **Producer B:**
  - Base milk marketings 1,000,000 lbs
  - Markets 1,200,000 million pounds in July
  - 1.2 million lbs. minus 98% of his base (980,000 lbs.) equals 220,000 lbs.
  - 6% of 1.2 million pounds is 72,000 lbs.
  - DMSP deduction from his milk check for July:
    - 72,000 lbs. X $14.00/cwt. = $10,080 deducted from Producer B’s milk check.

How the monies will be collected & managed

- Monies will be sent to a restricted fund at AMS-USDA
- A DMSP Board will be established for the sole purpose of determining the most effective use of monies collected
- DMSP Board shall represent a broad spectrum of producers
- Monies will be used to purchase dairy products for distribution to feeding programs and food banks to expand consumption and build demand
Economic Analysis of Foundation for the Future

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Three Independent Analyses of the Program

- Chuck Nicholson and Mark Stephenson
  - “Analysis of Proposed Programs to Mitigate Price Volatility in the U.S. Dairy Industry”

- American Farm Bureau Federation’s Economic Analysis Department
  - “AFBF Analysis of National Milk Producers Federation Foundation for the Future Proposal”

- FAPRI – University of Missouri
  - “Analysis of NMPF’s Foundation for the Future Program”
Summary

• All analyses show a reduction in margin volatility under FFTF policies
• The Dairy Market Stabilization Program (DMSP) does not trigger often, but when it does, it provides a quick way for markets to balance
• The supplemental feature of the DPMPP gives producers flexibility to add additional margin protection
• General agreement on the effects of FFTF policies by all authors
For further information, please visit www.futurefordairy.com or email info@nmpf.org.