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MCT COMPASS

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Taking a Wrong Turn

Earlier this month, the Secretary of Agriculture announced temporary increases in the support prices for nonfat dry milk, Cheddar barrel cheese, and Cheddar block cheese. Nonfat dry milk produced from August 1 through October 31 and sold to the government under the price support program is now valued at 92 cents, 12 cents higher than the 80-cent support price legislated in the farm bill. Likewise, the support price for Cheddar block and barrel cheese was increased 18 cents to $1.30 and $1.27/lb., respectively. The support price for butter at $1.05/lb. was left conspicuously unchanged, and the spot butter price has fallen 7.5 cents, mitigating some of the gains from raising the support price for nonfat dry milk.

What makes these immediate and temporary increases in the support prices interesting is that the support level increases are three times higher than those suggested by the National Milk Producers Federation (NMPF), the largest dairy producer lobby group in the United States. It is very difficult for those in the producer and processor community to criticize USDA's latest move. Dairy producers have faced an unprecedented decrease in revenue this year. To criticize the higher support prices makes one appear coldhearted. But to praise the hikes and lobby for additional increases is not in the best interest of U.S. dairy producers.

The support price program has proven largely effective at supporting the price of a single commodity — nonfat dry milk. During the past decade, government-owned stocks of nonfat dry milk peaked at more than 1 billion pounds in 2002. It took USDA four years through various giveaway and barter programs to deplete its stocks by the end of 2006. In particular, about one-third of USDA's stocks were basically given to livestock producers in drought stricken areas. That powder displaced other ingredients like dry whey, whey protein concentrate, and lactose in feed formulations.

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KEN'S CORNER

by Ken Meyers
President
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Breaking away from government-supported programs like the dairy product support price program and state and federally regulated milk pricing is very difficult because the industry has operated with these programs for decades. Perhaps they were appropriate for the dairy industry that existed at the time of implementation. But times have changed.

The United States is well positioned to compete on the global market without the use of price supports and export subsidies, which just distort market signals. Perhaps manufacturers of nonfat dry milk could follow the example of Cheddar cheese manufacturers, and in lieu of selling to the government, clear their products to the commercial market with finality. Cheese manufacturers find selling product to the government under the support price program a challenge. The cheese spot market provides a market clearing price, which helps avoid large surpluses of government stocks that only serve to depress the commercial market.

Undoubtedly, this leads to periods when prices fall below support, but it also paves the way for a quicker market recovery because there are no stocks overhanging the market. Disrupting market dynamics through government intervention creates a seesaw effect that results in more price volatility and hinders decision making capabilities of producers, manufacturers, and end users. MCT

Unsettled...

There is currently short-term weakness in the cheese and butter markets. Some believe that in the near future cheese and butter markets will rise due to a seasonal tightening of milk supplies and Cooperatives Working Together (CWT) activities. Others believe that stocks overhanging the market will keep prices lower than expected. What makes forecasting dairy prices for the remainder of 2009 challenging is predicting the convergence between dairy producers' break-even point and the milk price based upon a bundle of dairy product prices. **MCT**

MCT Forecast

	Block*	Barrel*	Butter*	Whey**	NFDM**	Class III	Class IV
Aug	1.3471	1.3271	1.2005	0.2919	0.866	11.20	10.40
Sep	1.3650	1.3400	1.2350	0.2871	0.907	12.40	10.70
Oct	1.4250	1.4000	1.3225	0.2811	0.915	12.70	11.15
Nov	1.4850	1.4600	1.3550	0.2696	0.918	13.25	11.40
Dec	1.5075	1.4825	1.3150	0.2597	0.919	13.60	11.30
Jan	1.5225	1.4975	1.3025	0.2579	0.907	13.75	11.10

** Block, barrel and butter are monthly averages of CME prices.*
***Whey and NFDM are monthly averages of NASS prices.*

A better way..

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Raising the support price is an inefficient method of income transfer to U.S. dairy producers. The government must buy and store product to clear the market. The short-term bump in the nonfat dry milk price only raises a portion of a dairy producer's milk price. Longer term, USDA must eventually return the powder to the market, which can also have market distorting impacts.

In addition, the recent increase in the nonfat dry milk support price sparked the world market price to move up to just below the U.S. price umbrella, distorting prices both internally and externally, while allowing competition to capture market share, which will increase farm-gate milk prices to competing producers.

USDA could support dairy producers equally across the country by eliminating the size restriction on Milk Income Loss Contract (MILC) payments. Dairy producers are eligible for the MILC payment on the first 2.985 million pounds of milk produced in the fiscal year. This is roughly equal to the annual milk production of a 150-cow dairy. The MILC payment occurs when the Class I price mover is less than \$13.69/cwt. Between February and September 2009, the MILC payment ranged from \$2.00/cwt to \$1.25/cwt. The impact on producers' milk checks is significantly higher from MILC payments than from the increase in support prices, plus MILC payments do not have the consequential effect of building burdensome stocks.

Demand-driven government programs could also help alleviate the dairy product surplus as long as commercial sales are not displaced. USDA could increase funding for the school milk program, add more dairy products, like yogurt, to the list of eligible products in the Women, Infants, and Children (WIC) program, and promote greater use of dairy in military rations and institutions.

Of course, the free market is another option. A year ago, Class III futures offered producers the opportunity to sell milk for more than \$17.50/cwt. USDA sponsors a risk management program that few producers have utilized. Risk management programs could be expanded to attract greater participation.

Could it be that doing nothing is better than doing something? In terms of dairy policy, every action appears to be met with an equal unintended consequence. Raising support prices leads to greater milk and dairy product production, which results in the government acquiring stocks that will eventually need to clear the domestic market. It also leads to export subsidies so U.S. and foreign products can compete on the global market. This depresses global markets, which leads to the need for higher support prices. And the cycle continues. **MCT**

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