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MCT COMPASS

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# No Real Change to Pricing

Last week, the U.S. Senate on a vote of 64 to 35 passed the 2012 farm bill, which could dramatically change U.S. dairy policy. A similar bill has yet to pass the U.S. House of Representatives, and a joint committee would need to reconcile any differences between Senate and House versions of a 2012 farm bill. Still, it is worth taking a look at what was and wasn't in the Senate bill.

*Nothing in the bill streamlines the process of making changes to federal orders, thus the process of future federal order changes will remain lengthy and cumbersome.*

First, the Senate bill contained both the dairy stabilization and margin protection programs championed by the National Milk Producers Federation (NMPF) and detailed in last month's *Compass*. To see the May issue, visit mctdairies.com.

An earlier version of the Senate bill contained a provision, which mandated that the Federal Milk Marketing Orders eliminate product formula pricing and instead adopt a competitive pay price similar to how milk prices used to be determined prior to federal order reform in 2000.

The current product formula pricing system is opposed by large factions of both the producer and processor sectors because product formula prices lag spot markets and the make allowances embedded in the formulas are difficult to change even when costs, particularly energy prices, are volatile. That provision, however, was stripped from the earlier bill and replaced by an amendment that requires USDA to conduct a study to determine whether a better pricing system than the current product formula pricing system exists. The amendment is now part of the Senate's 2012 farm bill, but it does not require USDA to actually make changes.

Another mandate, which is also part of the bill, requires USDA to look at whether the milk pricing system would be more efficient with two classes of milk rather than the current four-class system. Nothing in the bill streamlines the process of making changes to federal orders, thus the process of future federal order changes will continue to be lengthy and cumbersome.

The Senate bill eliminates the existing Dairy Product Price Support Program, the Milk Income Loss Contract (MILC) deficiency payments, and the Dairy Export Incentive Program (DEIP). The margin

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## Ken's Corner

**by Ken Meyers**
**President , MCT Dairies Inc.**

The 2012 farm bill, while making headway, is far from becoming a working reality.

Some members of the House agriculture committee are expected to challenge the supply management portion of the bill, and last week, the International Dairy Foods Association (IDFA) contacted a large number of representatives to voice opposition to supply management.

For those of us that look forward to the farm bill as a chance to enhance the competitiveness of the U.S. dairy industry in the global arena, this bill is a disappointment. Granted the elimination of the dairy price support program and the implementation of a margin insurance program are steps in the right direction, but tying margin insurance to supply management—even if voluntary—does nothing to enhance the competitiveness of the U.S. dairy industry.

In particular, we think the industry needs a pricing mechanism that is transparent and highly liquid. For example, at one time all Federal Order milk prices were set off the Class III price. A single class of milk used to establish all other milk prices provides opportunity for greater liquidity in milk futures.

Greater liquidity in futures would lead to using futures as the basis for longer-term contracts both here and abroad. **MCT**

# Trending higher...

Class III and IV prices posted their latest highs last summer at $21.67 and $21.05, respectively. Since then prices have trended lower but appear to have bottomed near $15.20 and $13.30. Indicators point to higher prices during the second half of the year, with exports providing support to cheese and nonfat dry milk (NFDM). Total cheese exports through April 2012 are 12% greater than last year, while NFDM exports are up 8%. Despite a 3.1% gain in American cheese production through April 2012, American cheese stocks as of April 30, 2012, of 623.2 million pounds are just 500,000 lbs. more than last year. NFDM stocks appear to be burdensome at more than 220 million pounds, but likely have moved to stronger hands. **MCT**

MCT Forecast

| | Block* | Barrel* | Class III | Butter* | Class IV | Whey** | NFDM** |
|---|---|---|---|---|---|---|---|
| Jun | 1.6295 | 1.5780 | 15.60 | 1.4725 | 13.35 | 0.5025 | 1.1075 |
| Jul | 1.6550 | 1.6550 | 15.50 | 1.5550 | 14.20 | 0.4885 | 1.1475 |
| Aug | 1.6750 | 1.6500 | 16.70 | 1.6000 | 14.65 | 0.4900 | 1.1775 |
| Sep | 1.7000 | 1.6750 | 17.00 | 1.6400 | 15.05 | 0.4975 | 1.2050 |
| Oct | 1.7500 | 1.7250 | 17.35 | 1.6500 | 15.20 | 0.5000 | 1.2275 |
| Nov | 1.7750 | 1.7500 | 17.70 | 1.6500 | 15.15 | 0.5150 | 1.2500 |

** CME prices.*
***NASS prices.*

# *Exports main concern...*

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insurance and market stabilization programs replace these programs.

One of the biggest concerns is how the new policy would impact exports. According to a new study conducted by Informa, the proposed supply management part of the bill would have a negative impact on exports in the short-run, but the long-run impact is less certain.

Over the past 10 years, U.S. exports have increased by 178%. Over that time, the majority of U.S. milk production growth has been funneled into export markets. To remain a consistent and reliable supplier to world markets, U.S. dairy prices have to be competitive with prices in key exporting regions.

Various studies have shown that the supply management part of the bill would be activated between 7.5% and 46.2% of the time. A trigger that relies on a comparison of NASS prices with world market prices both triggers and deactivates the stabilization program. The problem with that, according to Informa, is that NASS prices lag spot markets, and the trigger considers only cheese and nonfat dry milk prices to determine if U.S. prices are higher than world prices, yet cheese and nonfat dry milk accounted for less than 38% of U.S. dairy exports last year.

Moreover, the program would use producer money to purchase dairy products when the program is activated. In effect, this would keep U.S. dairy prices higher than world prices even after the program has been detriggered.

Over the past decade, growing global demand in developing nations has allowed U.S. dairy producers to sell more milk at a higher average price, the Informa study notes, and U.S. dairy product suppliers have invested considerable resources to take advantage of the growing export demand, which has worked to narrow the spreads between U.S. and global prices.

Both the price spikes that would result from the supply management portion of the Senate bill as well as the ongoing lagging prices due to the product formula prices currently used in federal orders could reduce the competitiveness of U.S. dairy products in world markets. **MCT**

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