

## Update on Dairy Markets and Policy - Policy Status Outlook

May 13<sup>th</sup>, 2013

From Chicago to Auckland—How  
Should Dairy Prices Be Discovered?

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## What a Great Task I Have Today!

- Presenting on an update to dairy policy outlook
- The day before the Senate Agriculture Committee holds markup
- Two days before the House Agriculture Committee holds markup
- The world could become much clearer in two days or it couldn't
- My timing remains impeccable**



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## Where Do Things Stand?

- Senate Agriculture Committee has the DSA provisions included in the Chair's mark
- House Agriculture Committee has the DSA provisions included in the Chair's and Ranking Member's discussion draft
- The most visible alternative today is on the House side as the DFA, in general terms DSA without DMSP
- Still a long road to travel to get a new farm bill to the finish line
- One concept appears in all alternatives today, margin insurance

## Margin Protection (Milk Price Less Feed Costs) Has Been The Focus

- The combination of high feed costs and milk price volatility has led to the discussion of margin protection
- Protecting margins helps on government outlays because milk prices and feed costs are correlated
- This margin covers all other costs besides feed costs
- Need to measure producer response to margin risk reduction
- Producers are becoming more efficient over time
- Is this margin a good indicator of average industry margins?

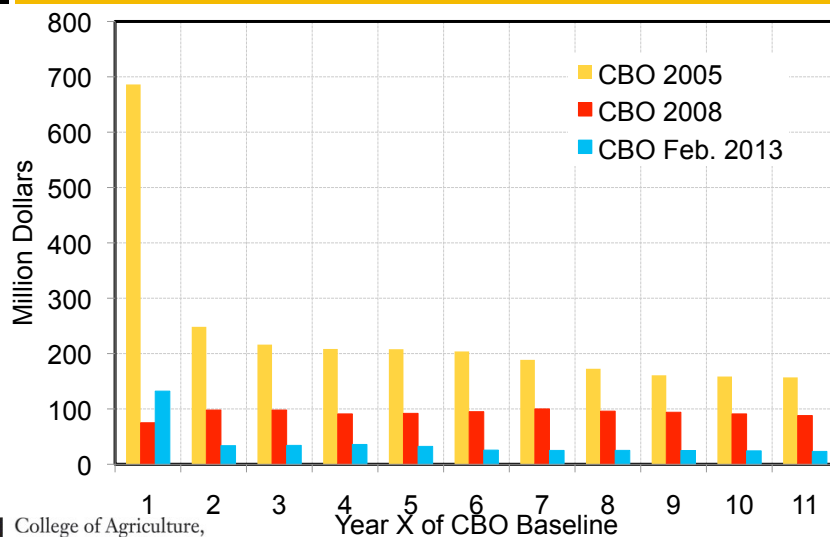
## Which Premium Levels Are Actuarially Fair?

Table 1. Premium Levels Based on Milk Marketings

Coverage Rate	DSA Supplemental Premium Rate		DFA Premium Rate	
	First 4 million lbs	Above 4 million lbs	First 4 million lbs	Above 4 million lbs
\$4.00			\$0.000	\$0.030
\$4.50	\$0.010	\$0.015	\$0.010	\$0.045
\$5.00	\$0.025	\$0.036	\$0.020	\$0.066
\$5.50	\$0.040	\$0.081	\$0.035	\$0.110
\$6.00	\$0.065	\$0.155	\$0.045	\$0.185
\$6.50	\$0.100	\$0.230	\$0.090	\$0.290
\$7.00	\$0.434	\$0.434	\$0.180	\$0.380
\$7.50	\$0.590	\$0.590	\$0.600	\$0.830
\$8.00	\$0.922	\$0.922	\$0.950	\$1.060

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## Dairy Baseline Declining With Higher Input Costs Raising Milk Prices



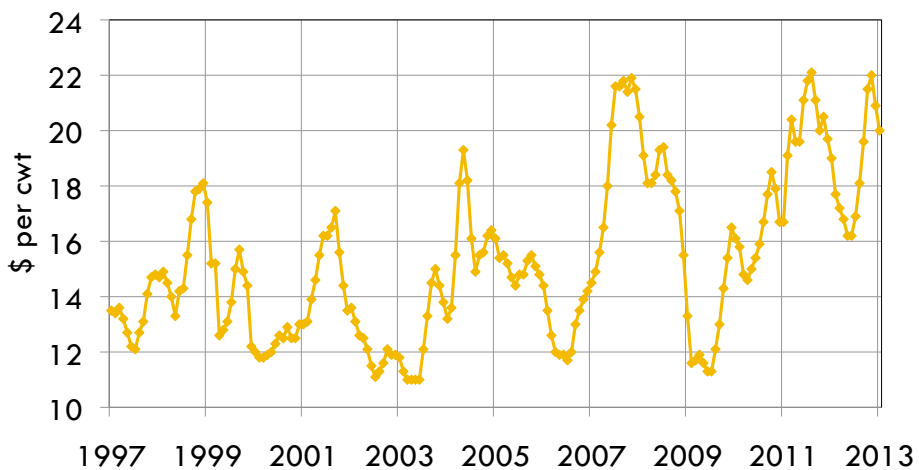
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## Let's Put This In Perspective

- USDA currently estimates 2012 dairy cash receipts at **\$37.0 billion**
- CBO Feb 2013 baseline spending on dairy programs average over the FY14 to FY23 period **\$28.4 million**
- **0.08%** is dairy spending relative to dairy cash receipts
- It is hard to construct an “effective” program with such small annual outlays

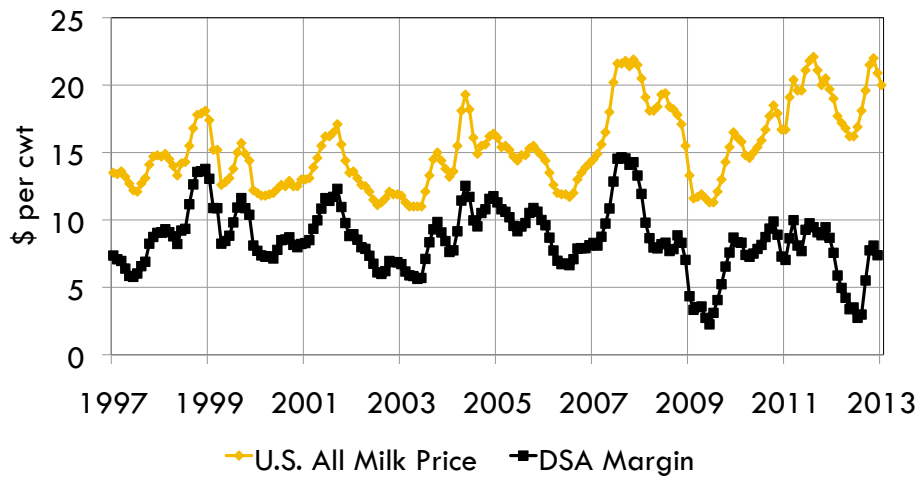
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## Monthly U.S. All Milk Prices



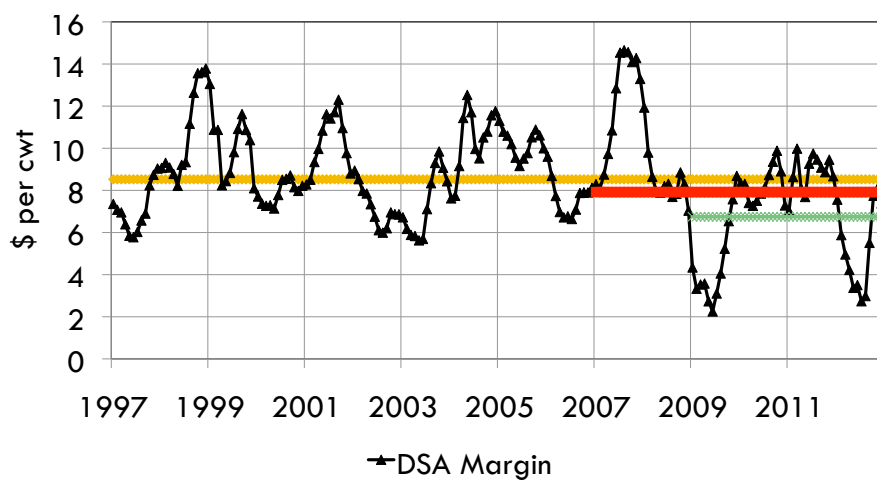
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## Dairy Industry Facing Milk Price and Margin Volatility



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## My Largest Concern? An Adequate Safety Net – Not Too Good Or Bad



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## Discussing These Margin Programs Requires Probability-Based Outcomes

- Something that we need to know more about – the distribution of producers' cost of production
  - ▣ Is the distribution narrowing?
  - ▣ Is the distribution widening?

## Discussing These Margin Programs Requires Probability-Based Outcomes

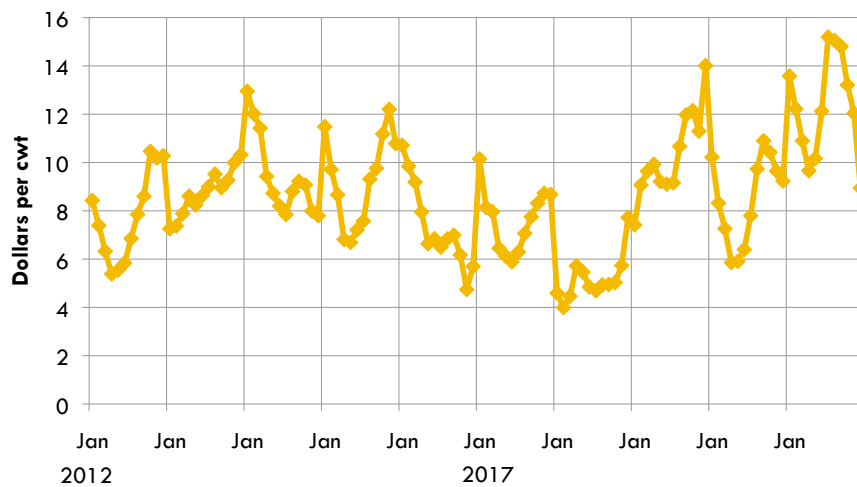
- Something that we need to know more about – the distribution of producers' cost of production
  - ▣ Is the distribution narrowing?
  - ▣ Is the distribution widening?
- A wider distribution gives us more room for error in setting policy levers
- Is demand for dairy products becoming more or less elastic over time?
- More elastic demand gives us more room for error in setting policy levers

## After All of the Detailed Work is Done

- The exact margin path will determine the cost and effectiveness of any margin-based program over the next five years
  - Domestic demand
  - International demand
  - Input prices
- Defining a program that is actuarially fair in the long-run is very different than one that spends on average little money over a five-year period
- We rarely experience any type of long-run equilibrium

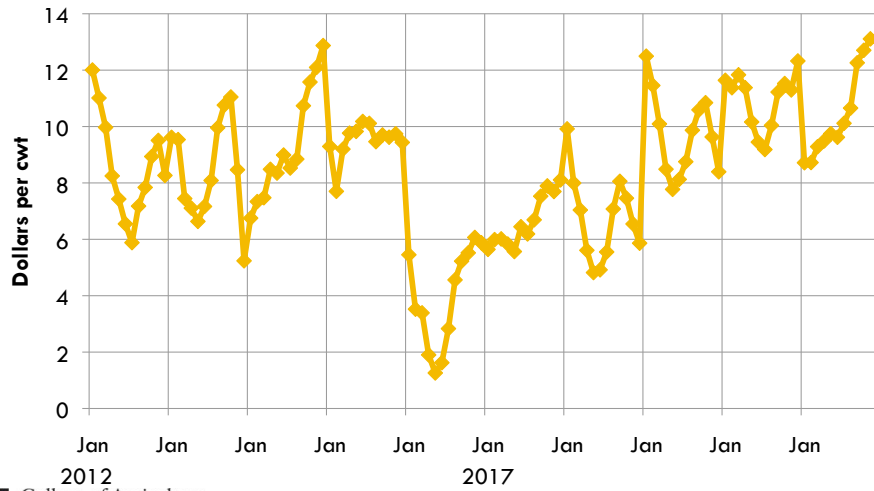
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## Monthly Margin - #88 Dale Junior Draw



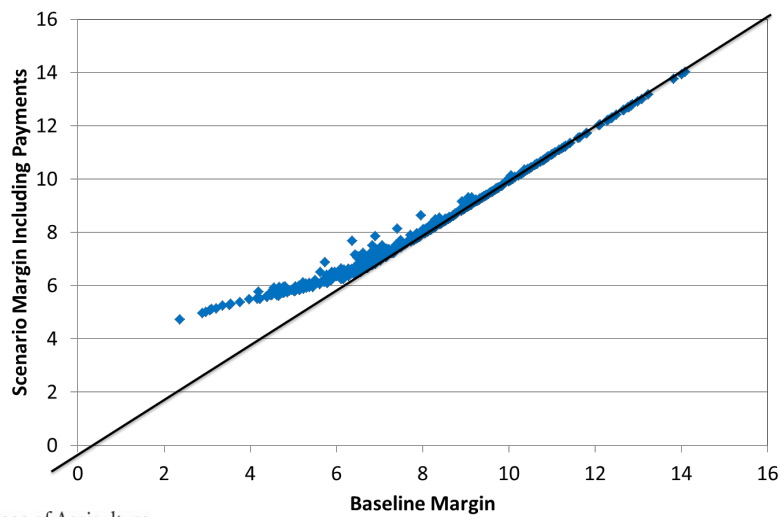
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## Monthly Margin - #99 Carl Edwards Draw



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## Baseline Versus DSA Margin Comparison



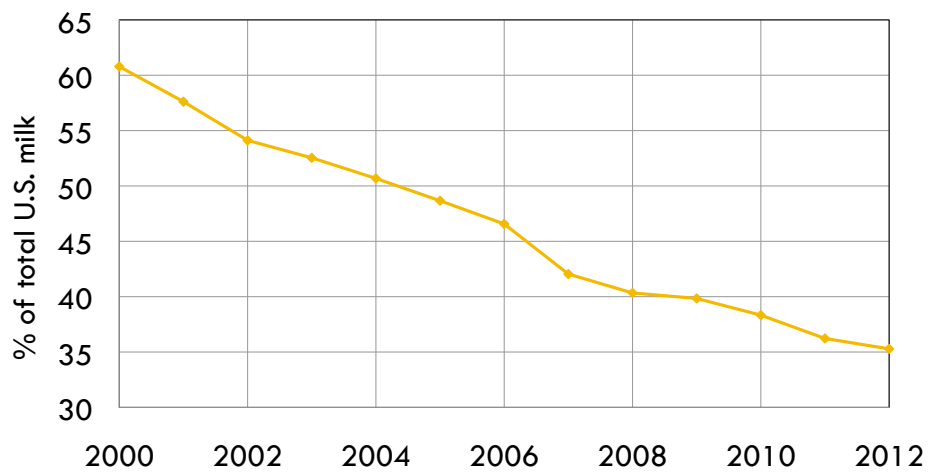
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## Base Determination Important to Program Effects

- A historically fixed base:
  - Helps limit government outlays
  - Reduces support over time for producers who grow
- A base that adjusts through time
  - Could result in producer expansion
  - Keeps support at the same proportion for an individual producer
- MILC provides a good perspective

## Eligible U.S. Milk Production With a 2.985 Million Pound Cap



## Summary

- Building a perfect policy is impossible!
- Two possible solutions in the running
  - ▣ One is a straight margin payment option
  - ▣ The other incorporates margin payments and managed supplies
- In the tight budget environment we face today in Washington, DC a tall task remains in discovering new policy
- Let's make certain we have thought through all the details in a margin-based program
- If we get new dairy policy I hope next year I can discuss what exists and implementation instead of speculating on what will occur