International Dairy Foods Association
Milk Industry Foundation
National Cheese Institute
International Ice Cream Association

IDFA Dairy Policy Recommendations

Introduction

The United States dairy industry is at a crossroads. Increased participation in international markets has resulted in steady growth of dairy exports so that today more than 12% of all U.S. farm milk ends up in dairy products sold overseas. However, being competitive in world markets has inevitably exposed our dairy farmers to the volatility of the international marketplace.

The world-wide recession that started in late 2008 was particularly hard on dairy farmers. A regulatory and support system that was designed to address economic conditions of nearly a century ago failed - and in many respects made conditions worse. In response, many dairy farmers have called on our Federal government to establish new mandatory programs that attempt to protect them against price volatility.

IDFA and its members are optimistic that our industry can continue to be a strong economic engine for our country. Domestically, dairy products have faced increased competition for shelf space but we can fight back with innovative, new products. Emerging markets like China and others throughout Southeast Asia present enormous opportunities for U.S. dairy products, creating growth for our producers and processors.

Our current dairy policies, however, are getting in the way. Producers and processors agree that our outdated policies and programs need to go. But before we replace them, we need to consider which direction to take, as different policy reforms will lead in different directions.

We can adopt policies that position us to compete in export markets and to develop new products for a growing but increasingly competitive marketplace. This path requires less government regulation and policies that will not encourage imports. If we choose this path, policy reform must address dairy farmers' need for risk management tools that allow them to succeed during periods of low net income. Conversely, they need policies that do not promote overproduction when net income is high.

Another approach would be to adopt policies that call on the Federal government to intervene in dairy markets to balance supply with demand in an attempt to control price volatility. As shown by the experience of similar programs in other countries, such policies would reduce U.S. dairy exports while at the same time exposing the U.S. to increased dairy imports. By increasing the consumer costs of dairy products here at home, such programs often result in a decline of domestic dairy consumption. While some dairy farmers and even some processors may do quite well under such a system, their success comes at the expense of opportunities for others as well as at the expense of overall growth of our dairy industry.

For IDFA and its members, the policy direction of continued growth is the easy choice. To move in this direction, we need to reduce the regulatory burden on our industry, to eliminate programs that make us less competitive, to reform the safety net for dairy farmers to give them the tools to manage price volatility, and to simplify the Federal Milk Marketing Order system. Because policies to manage growth run counter to our vision for the future, we strongly oppose any mandatory government programs to limit milk supply under the guise of managing price volatility.

Provide Risk Management Tools for Dairy

Around the world, governments are making notable changes to domestic and trade policies affecting their dairy industries. In Europe, the EU is nearing the end of reforming dairy policy, including phasing out farm milk quotas by the end of 2014. Australia ended federal dairy support programs and eliminated their classified pricing scheme in 2000. New Zealand became the fastest growing dairy exporting country during the past thirty years after eliminating dairy supports.

The combination of policy reform in other countries and increased dairy demand internationally has allowed the United States to become a major dairy exporter. Less than 10 years ago, the U.S. exported about 5% of U.S. milk production in the form of dairy products, mostly the result of government export subsidies under the Dairy Export Incentive Program. Over the past four years (2007-2010), exports have grown to more than 12% as a share of U.S. milk production, without significant government export assistance.

IDFA rejects proposals that rely on mandatory government programs that attempt to balance supply and demand or to limit domestic milk price volatility. Instead, we support policies that will help our dairy farmers manage that volatility. Rather than increasing government regulations and intervention into our markets, IDFA proposes policies that will help dairy producers manage risk with programs to provide assistance when margins are squeezed, but also with programs that remove incentives to add unnecessary production during good times.

- **Authorize farm savings accounts**

  IDFA proposes to amend the federal tax law to allow dairy farm operators to create special tax-deferred savings accounts. The Dairy Farm Savings Accounts would have no limit on yearly contributions but will not receive any Federal match. Income taxes on contributions and earned interest would be taxed the year when the funds are withdrawn. Contributions must remain in the account for at least 6 months to receive the favorable tax treatment.

This proposal will remove an incentive for dairy farmers to invest and increase production during good years simply for tax avoidance purposes. This will help address volatility by reducing the incentive to expand production simply to pay less in taxes to the government. Many dairy producers employ tax-avoidance strategies in high income years by prepaying expenses, purchasing equipment early, or by financing an expansion. The ability to achieve the same tax-avoidance results by depositing monies in a tax-deferred savings account would instead provide an incentive for dairy producers to save those monies for low income years.

A study conducted for the USDA's Dairy Industry Advisory Committee (DIAC), which made such dairy farm savings accounts one of its recommendations for dairy policy, found that this type of program reduced farm milk price volatility by about the same amount as other proposals which included supply management policies[1].

- **Government Subsidized Catastrophic Margin Insurance**

  IDFA proposes to provide risk insurance coverage to assist dairy producers when margins fall well below acceptable levels. Catastrophic insurance would provide a direct payment to dairy producers when the margin between the national all-milk price per hundredweight and a national calculated whole-farm feed cost per hundredweight falls to insured levels as determined by Congress.

  Dairy producers would be permitted to purchase higher margin coverage, by paying the actuarially-based premium necessary to obtain such coverage. Under similar programs for other agricultural commodities, the federal government pays a declining share of the premium above the catastrophic level, as determined by Congress, as the coverage level sought increases.

- **Simplify and improve existing risk management tools for dairy producers**

  IDFA proposes that the Livestock Gross Margin-Dairy (LGM-Dairy) program be made more accessible with higher funding limits; and proposes that the Livestock Risk Protection (LRP) program be extended for use by dairy producers.

  The current federal dairy farm risk management and revenue insurance products are under-utilized by dairy producers and are constrained by budgetary limits. With only modest modifications, Agriculture Secretary Vilsack has increased the use of the LGM-Dairy program in 2011 so that it has already reached its underwriting limit of $15 million.

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[1] "Initial Analysis of the Impacts of a Farm Savings Account Program on Price Volatility" by Charles Nicholson and Mark Stephenson of California Polytechnic State University, San Luis Obispo and University of Wisconsin-Madison; 17 September 2010.

At the same time, USDA should provide risk management education programs for the dairy industry. Finally, USDA should develop a credit mechanism (direct lending or credit guarantee) for first buyers of farm milk (cooperative or proprietary firms) to cover the margin deposits required on contracts for risk management between first buyers of raw milk and dairy producers.

IDFA further proposes that the milk forward contracting program contained in the 2008 Farm Bill be extended to include all classes of milk regulated by Federal Milk Marketing Orders and be made permanent.

Eliminate the Dairy Product Price Support Program and the Dairy Export Incentive Program

IDFA proposes elimination of the Dairy Product Price Support Program (DPPSP) and the Dairy Export Incentive Program (DEIP). The DPPSP hampers our industry's ability to compete by encouraging production of commodity products rather than products in demand in the marketplace and has proved to be an ineffective safety net for dairy producers. The DEIP was established when U.S. dairy products were priced higher than international levels to subsidize exports in order to make them competitive. It has not been used significantly as our commercial dairy exports have grown over the past decade.

Reform the complex Federal Milk Marketing Order system to make it simpler and less harmful to both dairy product innovation and price volatility

Federal milk marketing orders (FMMO) were established in 1937 to address challenges unique to the dairy industry during the post-Depression era. The dairy industry at that time lacked the sophisticated refrigeration, distribution logistics, and modern manufacturing practices that today allow the industry to efficiently serve the nation's population centers with a wide array of fresh milk and manufactured dairy products.

The FMMOs were also designed to balance the market power of dairy producers and manufacturers by requiring manufacturers to pay producers no less than minimum FMMO monthly milk prices. However, the structure of our dairy markets has changed dramatically since Federal orders were first established. Today, dairy co-ops are a potent force in the marketplace, controlling the distribution of more than 85% of the milk produced on the nation's dairy farms. The dominance of dairy farmer co-ops and their ability to forward contract outside the minimum FMMO price regulations have leveled the playing field - yet the FMMO system has remained.

The current FMMO system is a highly complex regulatory system that requires dairy product manufacturers and processors to pay different prices based both on what products are made from farm milk and where they are processed. To determine minimum prices, the USDA uses complicated formulas to establish minimum class prices for milk depending on its use. Milk is the only major agricultural commodity where our government sets different farm prices according to its use. This program keeps milk from moving to its highest-value use and stifles product innovation because it results in the manufacture of dairy products based on regulations rather than on market demand, which also results in greater dairy price volatility.

- IDFA proposes that all end product price formula based minimum prices under the FMMO system be eliminated. All dairy plants will pay whatever competitive price is necessary to secure a supply of farm milk; there is no minimum Federal order price that any plant must pay to independent dairy farmers or cooperatives.

- USDA will survey monthly all payments made by all dairy plants to independent dairy farmers and cooperatives for farm milk. USDA will publish a national weighted average competitive milk price, as well as regional competitive milk prices for as many multi-state regions as statistically possible.

- All existing federal order regulations other than price regulations will remain in place.

- Processors who have sales of Class I milk products (fluid products) will continue to pay existing Class I differentials into Federal order marketing area pools. USDA will distribute these funds equally among all dairy producers in each marketing area. The Class I differentials will be phased out over 5 years. The first year will have no reduction but the differential will be reduced by 20% in each of the following four years and end the year after.

In developing these positions, IDFA has considered and coordinated its positions with the recommendations of the USDA Dairy Industry Advisory Committee. IDFA notes that it agrees with nearly every recommendation of that committee, but many are not noted in this document because they are either recommendations that can be made without legislative action or recommendations, such as immigration reform, that are indirectly related to dairy policy. IDFA's support for increased use of risk-management tools is generally consistent with the DIAC's recommendations as is the Dairy Farm Savings Account proposal. IDFA's proposed FMMO reforms adopt the DIAC's recommendation that the system reject end product formulas. IDFA believes the DIAC's recommendation to further study the FMMO system was made with the purpose of simplifying the system.

IDFA's proposals do not accept the DIAC's recommendation to adopt a "growth management" program. That recommendation was narrowly accepted by the committee. In IDFA's view, "growth management" is a policy that is acceptable only if Congress decides to isolate our dairy industry from international competition. The DIAC's recommendations can be found at http://www.fsa.usda.gov/Internet/FSA_File/diac_final_rpt_0302.pdf.

IDFA also notes that these proposals are consistent with the policy changes recommended for the U.S. dairy industry to become a "consistent exporter" by a white paper prepared for the Innovation Center for U.S. Dairy in September 2009. That paper, entitled “The Impact of Globalization on the U.S. Dairy Industry: Threats, Opportunities and Implications,” recommends the consistent exporter approach and indicates that to reach that result the U.S. must undertake efforts to “reform FMMO and price support programs” as well as efforts to “improve forward contracts, futures markets and other risk management tools.” The report rejected an approach designed to isolate the US from international dairy markets entitled “Fortress USA” because it would ultimately “damage the U.S. dairy industry.” A key policy needed for that approach is the adoption of “supply management as a means to balance production and demand, and limit volatility.” The Innovation Center’s white paper can be found at http://www.usdairy.com/Globalization/GlobalImpactStudy/Pages/BusinessCase.aspx.