U.S. Dairy Policy and the Dairy Sector in the U.S. West

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Recent Market Conditions

• Historically high milk prices since 2006
  – Drought in Australia/NZ
  – Continued strong global demand for manufactured dairy products

• But also high feed prices
  – Ethanol
Prolonged Periods of Tight Margins for Dairy Farms

• Financial stress for many farms across the country

• Increased farm exits

• Increased debt/loss of equity for remaining farms

• Some increased cow slaughter, but mostly consolidation

• Some reduced yields, but total production continues to grow
  – CA, NM dairy have been more responsive to price signals than the rest of the U.S.
Total Milk Production (% of 2000 production), 2000-2012
Performance of Status Quo Policies

• Dairy Price Support
  – Mostly inactive for the last decade (high milk and product prices)
  – unresponsive to feed prices

• Milk Income Loss Contract Payments
  – Pre-2008, deficiency payment unresponsive to feed prices
  – Post-2008, payment formula adjusted to make payments more responsive to feed prices
Income over Feed Costs with and without MILC payments ($/cwt)
Performance of Status Quo Policies

• Milk marketing orders not getting a lot of attention in the U.S. dairy policy debate.

• But keep in mind that the farm price of milk is not a market price, but a regulated price.

• Also largely ignored: Livestock Gross Margin for Dairy
  – Evidence that it could be a powerful tool for managing price risk, but adoption has been slow (3% in 2010).
2013 Dairy Policy Proposals

• Dairy Security Act
  – Eliminate MILC and Dairy Price Support
  – Introduce Dairy Producer Margin Protection
    • Subsidized margin insurance that pays when a national average margin falls below a specified level ($4.00/cwt with opportunity to pay for protection at higher margins)

• Introduce Dairy Market Stabilization
  • Limits production to a % of historical base in months when margins are tight
  • 100% tax on any milk marketed over quota
Economic Effects of the Dairy Producer Margin Protection Program

• Similar to current MILC payments, but designed to be more responsive to feed costs.

• Shields producers from market conditions that indicate reduced production, and so induces greater production—exacerbating market conditions that triggered payments

• Costs born by taxpayers, and any producers that don’t receive payments—Gov expenditures for MILC approached $1 billion/year
Economic Effects of the Dairy Market Stabilization Program

• Restricts production/growth for individual farms when margins are tight
  – Similarities to supply management systems in Canada, EU....a first for U.S. dairy policy

• Reduced production (for some farms):
  – limits supply response of margin protection, taxpayer costs of DPMP

• Higher prices of milk, dairy products
  – Reduced consumption of milk and dairy
  – Reduced exports
Economic Effects of the Dairy Market Stabilization Program

• The DMSP transfers income from restricted producers to producers not facing binding quota.
  – From low-cost farms to high-cost farms
  – From good risk managers to bad risk managers
  – From growing farms to shrinking farms
  – From Western farms to Northeast/Midwest farms
  – From U.S farms to N.Z./Aus farms
Economic Effects of the Dairy Market Stabilization Program

• But there remains uncertainty about how the supply management program would play out in practice.
  
  – Who will sign up?
  – How will producers respond to on again-off again quota?

• “Market stabilization” implies that the quota will have a counter cyclical effect on margins.
  – Hard to imagine how this might be the case.
2013 Dairy Policy Proposals

• Current debate seems to be about if/how to implement the supply management program.

• Rep. Goodlatte-Scott Amendment
  – DSA minus the supply management

• Sen. Gillibrand proposal:
  – DSA with small-farm (anti-Western) bias
  – higher margin guarantee up to 4 mil. lbs (200 cows)
  – Smaller farms exempted from supply management