Dairy Day Message: Futures Opportunities Can Help Stabilize Milk Price Volatility

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EAST SMITHFIELD (Bradford Co.) — "At one time dairy policy commanded a lot of respect in Washington, particularly the farmer end of it," said Dr. Robert Yonkers, Penn State assistant professor of Agricultural Economics.

"Now days," he continued. "I don't believe that dairy has the clout that it used to have and there's a lot of reasons for that . . . but it's no longer a sacred cow. It's not a protected form of our government policy. Neither are any agricultural products."

Yonkers delivered his message to over 200 dairy farmers who attended Bradford County Dairy Day held at SRU High School, Monday, February 17.

Yonkers' message began with a look at the history of dairy economics and the rise of regionalism. "One of the reasons dairy lost clout has to do with the rise of regionalism. At one time if you supported dairy interests or if you were pro dairy farms just about anywhere in the country, you had pretty much common beliefs, common values and common goals toward what you wanted government to do toward the dairy industry. We had a much more homogeneous industry," he said.

In the past, he continued, farms of different sizes were much more similar in regards to the type of technology that was used. Today farms that average from 50 to 60 cows often use much different technology than those with 500-600 cows. Some variances include the housing systems, manure management and feeding systems.

"It's much more difficult to find common ground about what those different types of farmers and managers of those operations want in policies if they can get it," said Yonkers.

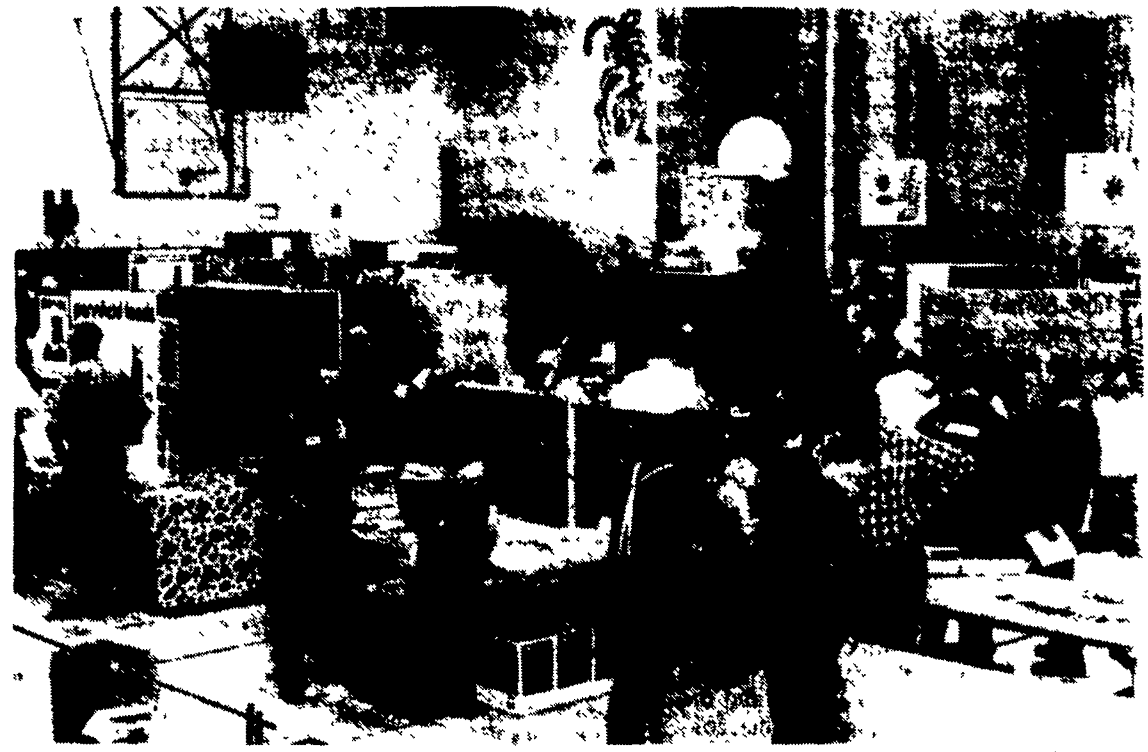
But if we examine them, we can treat the minor problem before it becomes a major one."

Bradford County Dairy Princess Robin Wilson and alternates Stacy Mattocks and Julia Wanck were also on hand throughout the day drawing door prize winners and distributing pounds and pounds of dairy products.

The first real split in policy, Yonkers said, came in the 1985 farm bill when Upper Midwest Cooperatives voted for a dairy termination programs when Southwestern Cooperatives didn't like the idea of a dairy termination program for fear that the milk supply deficit would grow even larger. Compromises led to higher prices in the Southwest and a dairy termination program. Another contributing factor was the regional shift in milk production. In the mid 1980s, the highest producing dairiy states each declined in production except Pennsylvania, while other states gained by leaps and bounds in milk production.

One of the biggest factors, however is the shift of government away from private industry. "These changes started back in 1981 and ever since then congress has been trying, and the president has gone along, to decrease the role the government plays in intervening in agricultural markets. This isn't something that's just happened in the past year. It's been a 15-year trend trying to undo the policies that we started with in the 1930s and '40s," said Yonkers.

The 1996 farm bill (FAIR Act of 1996) is also an attempt to get the government out of the farming business.



About 425 exhibitors and guests packed the gym and meeting rooms at SRU High School, East Smithfield, to learn about milk prices, forward contracting, earn pesticide credits and learn about dry cow care at Bradford County Dairy Day.

"This (bill) has a seven-year life instead of a four- or five-year life like our farm bills had been having. The reason is that the Republicans were real hot to include the farm bill in the budget bill. Well, they never got a budget bill so that means they didn't get an ag bill either, but the seven -year life is to reduce the budget deficit to zero."

The 1996 Farm Bill also has provisions to phase out price supports for wheat and feed grains in addition to phasing out the price support program for dairy.

Without the cushioning effect provided by a government that bought excess butter, powder and sugar to keep the prices above the support price level, prices will be more volatile.

"I think producers, with more price volatility, are going to need to pay a little more attention to what's going on in the markets, because what's going on in the market is going to affect their milk check," said Yonkers.

In addition Yonkers claims that there is an increased need to anticipate both ups and downs in the market. There is also a need for more risk management strategies to deal with the volatility.

One form of risk management is to invest in the futures market or hedging.

Jamie Zimmerman, Director of Field Services for Dairylea Cooperative noted that their cooperative as well as others now offer the opportunity to farmers to lock in milk prices well in advance through using forward contracting.

"We're seeing a large amount of volatility out there which translates into a fair amount of stress. One of the answers to dealing with the stress has come in the form of the futures markets and the futures contracts we've been trading," said Zimmerman.

Futures contracts are not new to agriculture. For many years futures for grain, coffee, sugar and many other commodities have been traded to offset the risk of a volatile market.

"From a producer's standpoint, using figures contracts are a risk management tool," Zimmerman noted.

In June of 1993 cheddar cheese and non-fat dry milk were traded on the coffee, sugar and cocoa exchange. Fluid milk futures followed in December of 1995. In January of 1995 fluid milk opened on the Chicago Mercantile Exchange and this past summer, butter contracts were introduced. A futures contract on the basic formula price (BFP) is expected to be introduced soon.

There are a couple of different ways to manage price risk. The first is hedging on your own. "A lot of large grain producers in the Midwest do a lot of their own hedging. That's when a producer shifts their risk from the farmgate to the futures market in order to establish a known price for their commodity well in advance of when it's produced or sold," Zimmerman explained. One other way to shift price risk is to do forward contracting.

"Basically there's an intermediary between the producer and the futures market," he said. Using an intermediary helps take the mystery out of the futures market.

"We see this as an aid to business planning," said Zimmerman. "The basic function of business management is planning. If we don't know what we're going to plan, it's hard to get one of those basic things done. But if we know what some of the things will be in the future, like the price of milk, it's easier to plan," he noted.

In order to take full advantage of forward contracting it is essential that each farmer know his or her cost of production — not the USDA average — the individual costs of each farm.

"You must understand the cost of production," said Zimmerman, "It doesn't make any sense to lock in a price that won't be profitable for you."

Zimmerman is quick to caution that the futures market may not be for everyone.

"If it will bug you that your neighbor received five cents more for his milk this month than your contract price, then this is not for you. If you want to plan for the future and guarantee a price, then this may be for you. These are tools to be used when the opportunity presents itself," he said.

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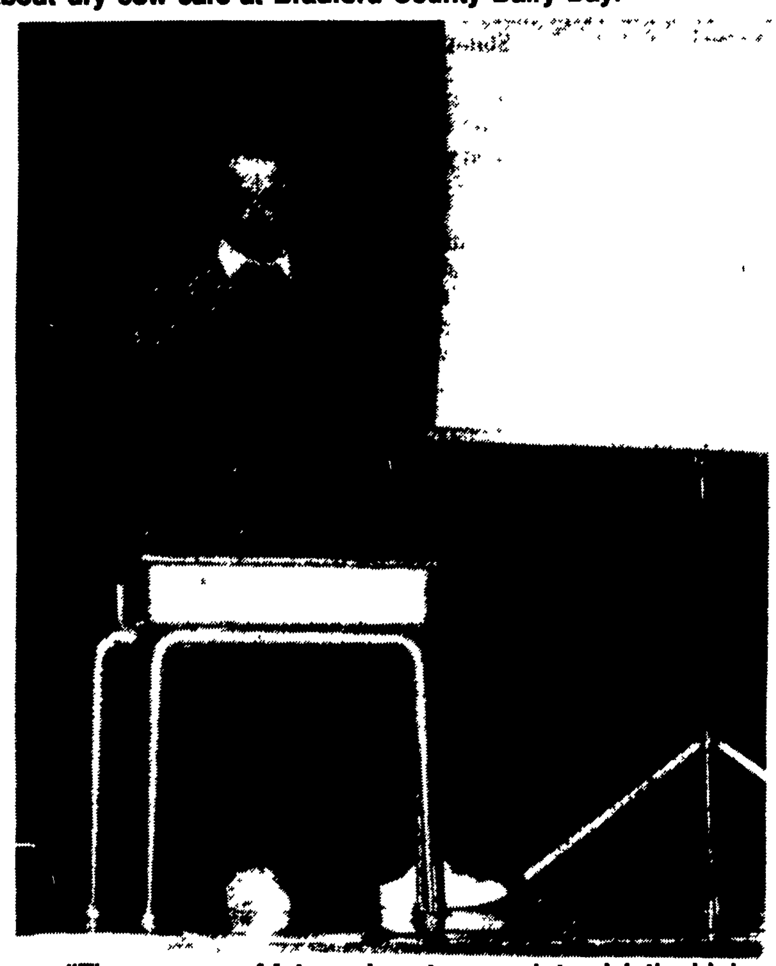
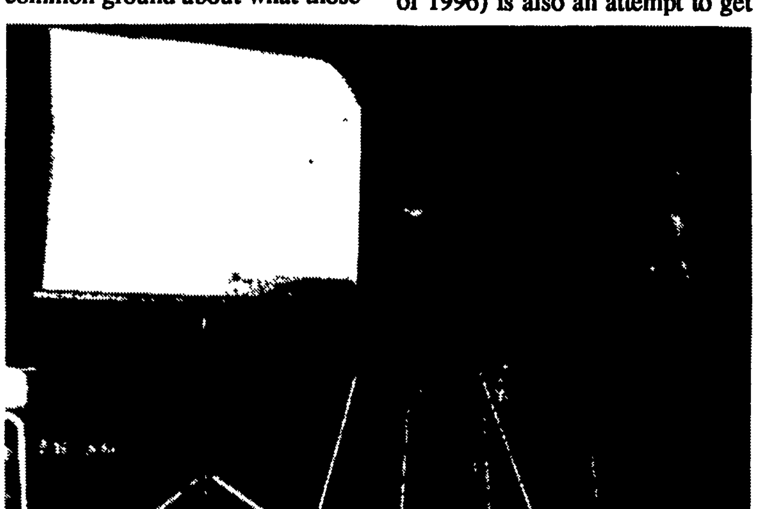
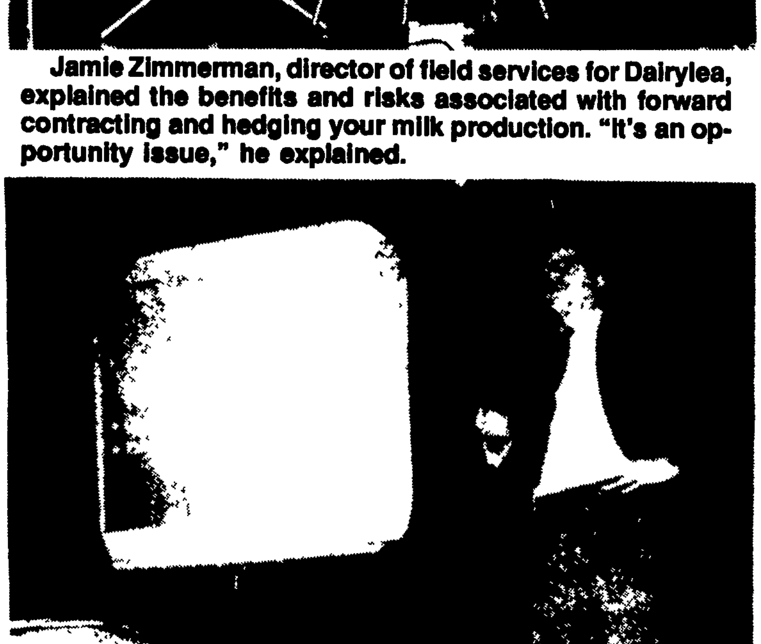


"The purpose of futures is not so much to pick the high prices, but to protect yourselves from the low," said Glenn Gorrell, a dairyman from Smithfield, who shared some of his own experiences with forward contracting his milk.



Jamie Zimmerman, director of field services for Dairylea, explained the benefits and risks associated with forward contracting and hedging your milk production. "It's an opportunity issue," he explained.



Penn State Assistant Professor of Ag Economics Robert Yonkers explains why dairy policy is no longer a "sacred cow in Washington" at the annual Bradford County Dairy Day.