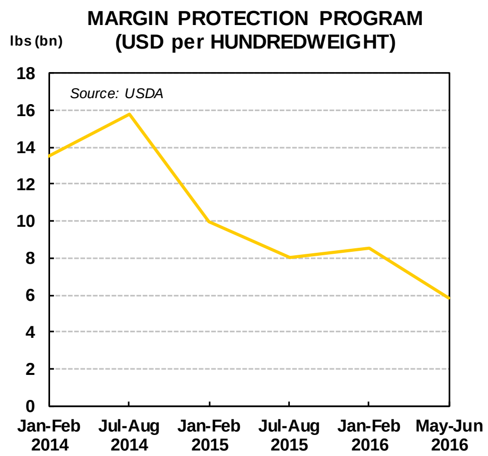
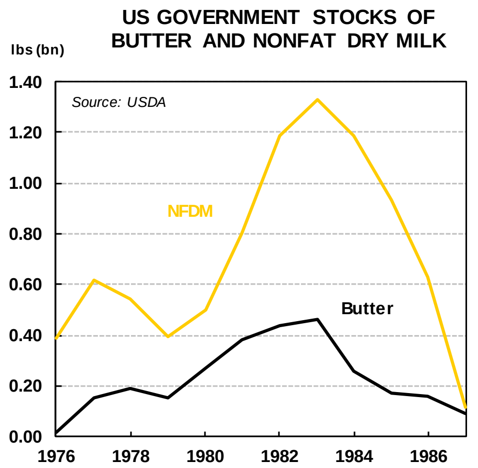
Back to the future

- **The US Department of Agriculture will buy cheese to support dairy prices.**
- **Purchases will be made using 80-year-old legislation.**
- **This could indicate a return to more interventionist US agricultural policy.**
- **Indeed, in a more protectionist world, NZ stands to lose.**

The hands are out…
In early August of this year, the National Milk Producers Federation (NMPF), a commodity group representing US dairy farmers, requested that the United States Department of Agriculture (USDA) purchase dairy products to boost domestic cheese prices. The group wanted USDA to use both Section 32 authority (authorized in the Agriculture Act of 1935 which permits USDA to purchase surplus food for the benefit of food assistance programs) and the Dairy Product Donation Program (DPDP), a dairy price support program authorized in the most recent Farm Bill. Under both programs, the USDA purchases dairy products and then donates the products to non-profit organizations that provide nutrition assistance to low-income groups.



…and the USDA has bowed to the dairy lobby pressure
In response to the request, USDA announced it will purchase about 5000 metric tons of cheese from the private sector, at an expected cost of $20 million USD. USDA justified the purchase by noting that dairy revenues have declined 35% during the past two years and stocks of cheese are at a 30-year high. USDA did not use the DPDP purchase authority that was requested by the NMPF. It chose, instead, to use Section 32 authority. This is the first time that Section 32 funds have been used to purchase surplus cheese. By using Section 32 authority, the relationship between efforts to support cheese prices and USDA's action was not explicit.



There is, however, a direct link to market realities for the DPDP program, which is set to operate when dairy production margins drop to $4 and could be implemented in addition to Section 32 purchases. The most recent margin calculation showed margins at $5.76. NMPF's call for USDA to purchase products to support prices could be the first step in a shift of US agricultural policies that would have a direct, and negative, impact on New Zealand's dairy sector.

The USDA is turning back the agricultural policy clock…
A long-established method to support commodity prices is for the government to enter the market and purchase products, as with the DPDP and Section 32. Another historical method to support prices has been for the government to provide storage programs to keep the surplus commodities off the market. However, in the most recent Farm Bill, those policies were replaced by margin protection or income protection programs, with less focus on supporting commodity prices. The thinking was that the best cure for low prices are low prices and that government purchase or storage programs give incorrect signals of market needs. With current income protection programs, producers are protected – to a certain extent – from the vagaries of the market while prices are permitted to move to levels that reflect commercial supply and demand. However, in its reaction to commodity group pressure, the USDA has turned the clock back and is again purchasing dairy products to support prices.

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…and returning to the bad old days of market distorting policies

For a number of years, the USDA purchased butter, cheese and nonfat dry milk. The products were stored in a variety of locations around the US, including underground caves. At one time in the early 1980s, there was enough nonfat dry milk in government storage to meet domestic demand for 3 years and government inventories of butter sufficient to meet domestic demand for nearly one year. Those inventories were slowly drawn down through a combination of domestic nutrition and feeding programs or exported through a variety of international food-aid programs. Government stocks have declined dramatically over the past few years and today USDA's inventory of dairy products stands at zero.

The challenge with the government stepping in and purchasing commodities to support prices is that the products purchased don't suddenly disappear. While ownership changes hands, from the private sector to the US government, the products – cheese, butter and nonfat dry milk – are still around.

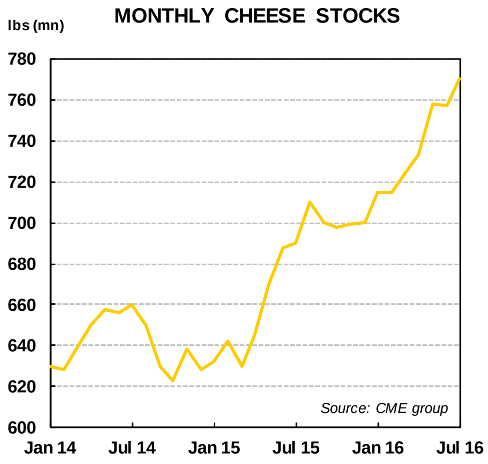
As mentioned above, the normal process is for the government to buy a product and then put it into the market through nutrition or feeding programs, both at home and abroad. Those actions often move prices down as commercial sales are crowded out by government donations. So, to keep prices up, farmer organizations demand the government store the product until prices stabilize before releasing the product into the market.

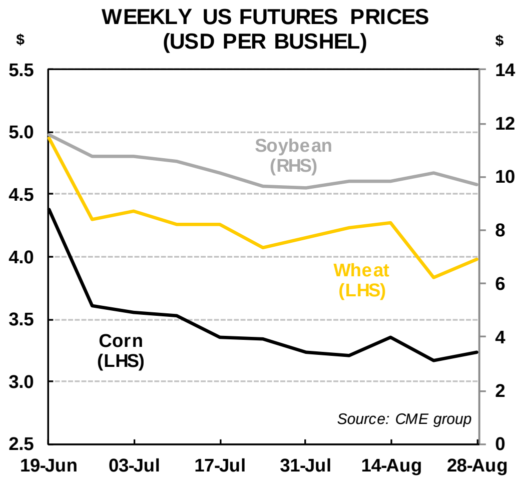
Another consequence of government purchase programs is they provide an opportunity for some to demand the implementation of import restrictions, such as quotas. The thinking is that imports drive prices down and work against government efforts to support prices. Because of unrestricted imports of the commodity the government is purchasing, it is believed that government programs are more expensive than would be the case without the imports. Thus, to save money, imports need to be restricted. Such action, which could easily follow from programs to support prices, would have a direct and significant impact on New Zealand exporters.

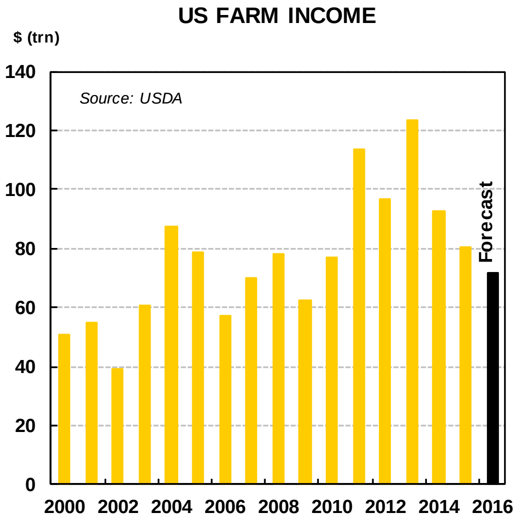
Although the dairy lobby is arguing for a tit-for-tat response to EU support

A key factor the NMPF pointed to in its request for USDA action is the "prolonged slump in global dairy markets". They refer to two important causes of that slump – the world wide drop in demand, particularly from China, and the surge in European Union (EU) production after production quotas ended last year. The growth of EU production has resulted in increased exports of dairy products at what the NMPF call "below-cost market clearing levels". The NMPF believes increased European exports have harmed US exports, resulting in US stocks of American cheese growing more than 20% over the past 12 months.

Without suggesting anything specific, the NMPF also requested that the USDA take action to increase direct payments to US dairy farmers. Their request did mention that dairy farmers in other major dairy-producing countries receive government support, citing the more than 1 billion Euros in agricultural assistance provided by the EU during the past 12 months, with a substantial amount of that total going to EU dairy farmers. The reference to EU payments, without calling for equivalent US action, may be an attempt to set the stage for new US farm legislation that could provide increased levels of government farm income support for a broad variety of commodities, including dairy.







The response opens the door to support for other agricultural sectors

With the USDA's response to a call for government action to help combat low milk prices, the door could be opened for similar calls from other commodity groups. Cash prices for corn have dropped 27% over the past 3 months, recently hitting a 7-year low, soybean prices are down 17%, with wheat prices down 22% - price declines more precipitous than dairy's. US farm income is forecast to decline for the third straight year, dropping almost 40% from 2011 and farmland values also dropping.

In a more protectionist world, NZ stands to lose

It is against such a background, mixed with potentially significant political changes in Washington, DC and the possible rejection of the Trans Pacific Partnership, that a call might be heard for a return to the agricultural policies of the past to combat today's farm level economic stress. Such policies could include renewed government storage and purchase programs, direct farmer payments, import quotas and, possibly, export subsidies. Such actions, if taken, will take time to implement, but USDA's response to commodity group pressure, using 80-year old authority for the first time, may indicate the clock has started to run.

Looking at the US move specifically, greater domestic policy support will further delay New Zealand access to the large and lucrative US market. But US policy moves may also have wider consequences. In particular, New Zealand has benefited from the general trend towards somewhat freer agricultural trade over recent years – the US relaxation on dairy product import quotas, for example. If these gains are reversed, or even stopped, New Zealand agriculture will lose one of the drivers of growth and higher incomes over recent years. Indeed, with the US possibly introducing more protectionist policies, other major producers may soon follow. This would be a major step backwards for agricultural policy, and a step that New Zealand, plus other global producers and consumers collectively, would hope to avoid.

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