

Organic Dairy Policy and Production Trends

By Kathie Arnold

Within a month, there will be three times as many farms shipping organic milk from my township. For years, we have been the only organic dairy farm in Truxton, but will be joined by two other farms by June and a fourth farm is planning to start their herd transition this fall. That will mean that by the fall of 2008, 40% of the dairy farms in our town will be shipping organic milk (that's assuming that the other six non-organic farms will still be in business then). When my husband, his brother, and I started in partnership in 1980, there were 22 farms shipping milk in our town—now it's down to 10. Organic is being seen more and more as a management system and philosophy that is doable, and a viable way for grass based dairies to capture more market place dollars.

We are now in the big organic milk flush period due to the expansive numbers of farms who started their herd transition last spring coupled with the normal spring flush. Numbers I'm hearing point to a 30-50% increase in organic milk supplies coming out of this period. However, on a Dean Foods Earnings Conference Call on May 3rd, Gregg Engles, CEO and Chairman of Dean Foods, parent company of Horizon Organic, said that their supply was growing by 25%. So if the supply of the largest player in the market is only growing by 25%, perhaps the flush of new milk isn't quite as big as some might have thought.

Whatever the size of the actual increase, the supply will be greater than demand for at least a period of time and all the major buyers of organic milk in the Northeast have put out the word that they do not plan to sign on any more milk until fall of 2008. That means that any farms that were planning to start their last year of transition this spring or summer should be sure to have a contract with a buyer, otherwise a market may not be available next spring or summer.

We are now back to what was the tradition for many years--processors not taking on new organic milk during spring flush, but looking to build new supply in the fall of the year. Over the last few years, processors have been willing to sign on new milk any time of the year. This was atypical and was a reflection of under-supply. Now that the organic milk market is out of the deficit supply situation, there will be more measured sign-ups. Most processors are not planning to sign up any additional farms to start their 1-year herd transition year until this fall.

It does look like this year's big surge in transitioning dairy farms will be a one year blip. Applications at

many certification offices are back to more typical pre-2006 levels and with the rising price for conventional milk, there will be less incentive for producers to transition—although higher conventional milk prices may give those planning ahead a financially easier transition. However, it will take some time for the market to digest this extra large dose of organic milk coming on line.

Already, some organic milk is heading to the conventional market to balance current supply and demand. Processors cannot always gear up new accounts and expand sales as fast or quite in tune with the increased supplies that the current situation is delivering. The fact that conventional milk prices are rising will help stem the financial losses that selling to the conventional market brings to bear. Unfortunately, this excess organic milk is impacting producers. Some co-ops and groups in the Midwest who supply the spot market have had to reduce their pay price to adjust for the lower pay they are receiving from buyers and in some cases, to compensate for the necessity to sell on the conventional market.

Our farm's buyer, HP Hood, has recently made the decision that all new contracts will be at a \$24 base price with a \$2.50 Market Premium versus the \$26.50 base price that was established at the beginning of 2007. The Market Premium will allow Hood the flexibility to reduce the pay price should other processors drop their pay price. Mike Suever, Vice President of Milk Procurement and Processing at HP Hood, has pledged, however, that Hood will not be the first to lower the Market Premium, but will only do so if another major processor does so first. This change will only affect Hood producers who have signed a contract recently under this new pricing or those of us whose initial contract periods have passed. We have been told that we will be receiving notice letters that contracts with the new pay distribution will be forthcoming.

On the May 3rd Dean Foods conference call it was good to hear that CEO Engles is now saying that he does not see a dropping farm gate price for organic milk. This is a change on his part, as noted in the question and answer section of the call by Chris Growe, AG Edwards analyst for consumer staples, who observed that Mr. Engles had previously thought that milk costs would come down.

Mr. Engles says that no one in this environment seems to be thinking short term, but all want to protect their supply. Although Dean Foods did not own Horizon Organic at the time, I'm sure they are fully cognizant that on the occasion when Horizon did drop their price to farmers (when they bought out Organic Cow) that they did indeed lose supply--as many farmers left Horizon rather than take a pay cut of \$1/cwt of milk.

Let us hope that both Mr. Engles from Dean Foods and Mr. Suever from HP Hood are true to their word, for if both are, then Horizon won't lower their producer pay price and subsequently neither will HP Hood. The other major buyer, Organic Valley / CROPP Cooperative, has a long history and a foundation principle of steady and increasing pay prices without price drops. With rising costs for organic feed, fuel and other inputs, any drop in farmer pay price would be doubly economically damaging to producers.

Pasture and Replacements

And what about the NOP pasture rule and replacements issue? There's nothing to report except to pass on what Mark Bradley, Deputy Administrator of the National Organic Program said at the National Organic Standards Board (NOSB) meeting in March. *"Pasture requirements for ruminants is still currently in internal, in departmental clearance, but we're expecting some activity on that. Dairy herd replacement requirements, as soon as we get done with the pasture requirements, we'll immediately move into rule making on that. And there is already a work plan in place for that."*

When asked by NOSB member Kevin Engelbert to specifically expound on where things are at with the pasture rule, Mr. Bradley replied: *"The pasture rule, we said that we would have, try to have something out by August of last year, and then we said, by the end of the year, and now we are saying by the end of this year. It is a work load based issue."*

It's been in...internal clearance for a matter of months now. The Office of General Counsel and the Office of Management and Budget will be involved in that clearance process. Exactly how long that takes, and even once we get a proposed rule out,...there'll be substantive comment involved with that.

That process will involve at least, I would say, 90 days of public comment to make sure that everything is well vetted. And then they would have to go back into considering those comments, putting that out as a proposed rule and then go ahead and publish that. But its work load, Kevin. It is exactly work load. We have a lot of things going on."

It seems that is the story of most of our lives—more to do than there is time to do it.♦