

# Globalization is speeding up

## Industry prepares for opportunities and volatility

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Special for Farmshine

PLAINFIELD, Pa.—There's a seven-billion-pound 'sliver' of unmet demand at the top of a forward-looking graph, and the question is: Who will fill it? That is the silver lining for U.S. dairy producers as the world economies shift to an increasingly global marketplace.

In fact, the analysis shared with dairy producers last week show world import needs are expected to increase 14% by the year 2013. That's 8.5 billion metric tons. The U.S. can account for 7% of that, experts say. But that leaves the sliver of yellow at the top of the graph, which represents the unmet demand as seven billion pounds of raw milk.

Along with the optimism and opportunities these figures suggest, is the 'frightening' levels of price volatility that accompany what has become the rapid globalization of the dairy industry.

Nearly 150 dairy producers and agribusiness representatives gathered at the West Pennsboro Fire Hall last Thursday to hear from speakers on milk marketing at the state, national and global levels. The program was the third Dairy Industry Issue Forum of 2009 presented by the Professional Dairy Managers of Pennsylvania (PDMP). The morning program was themed "Dairy's Place in the Global Market."

Speakers included Alan Reed, senior vice president of U.S. Manufacturing and Ingredient Marketing for Dairy Management Inc. (DMI); John Howard, staff attorney for the Pennsylvania Milk Marketing Board, and Robert Schupper, dairy category manager for Giant Food Stores.

Reed kicked off with his presentation on the impact of dairy globalization. He has been involved in milk marketing for the past 10 years, and DMI has taken a "global view" of milk marketing since 1995.

Reed referenced a study completed recently by Bain & Co. for DMI's U.S. Dairy Innovation Center, and its Global Task Force, which details the economic shifts and provides a strategic analysis of the global landscape.

"We started with the idea that the world is flat for dairy," he said. "This industry has 'grown up' in a relatively regional marketplace, but now we've seen it go global. No one can escape the impact of globalization—even if you are selling your milk to a local processor."

In one year's time, producers have seen the impact as the international market for U.S. dairy products grew to 11% of U.S. production in 2008 and then collapsed to 8% in 2009.

"It's frightening that we are dependent on that demand," said Reed. "But analysts all agree that it will come back... and down the road, this global demand is expected to grow faster than the available supply."

Questions are: When, how, and for how long?

Reed observed that globalization will not go away, and it will in fact "speed up," he said. "Markets will become more volatile, and the industry will need to manage this volatility all along the supply chain."

This means a strategic industry response will be necessary. "Existing practices and pricing methods are designed for more insulated markets," he said. "Globalization is not just a discussion of export markets, it is the realization that the world marketplace affects the industry both externally and internally."

DMI has put together a Global Task Force, with members representing a cross section of industry leaders, from producer cooperatives to processors. "Their goals are strategic," said Reed. "If we know what's coming, we can prepare for what's coming."

But the first step in building strategic objectives was to get the industry together to identify



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for Dairy Management Inc. (DMI)**

the opportunities and challenges, to agree on what they are, even if they don't agree on how big they are.

Reed talked about raw statistics from the birth rate in growing economies to the future capabilities of the traditional sources of global supply. He said the data projections show there will be 800 million new middle class consumers in the next 10 to 12 years.

"The middle class consumes enormous amounts of dairy," he said. "What we saw in this current global economic crisis is the middle class being pushed back down into poverty. Looking beyond the current crisis, there will be new mouths to feed, and the country that is best positioned to feed them is the U.S."

China, for example, is becoming a significant dairy importer. They are growing their own herds, but not growing them as fast as their birth rate is growing.

India, said Reed, will be the world's largest dairy consumer and producer.

Mexico, right now, is the largest export market for U.S. dairy.

Russia is a large importer. But they, and other eastern block countries, are growing their herds as well.

New Zealand continues to be the largest dairy exporter, but they are not a large country, and their dairy model is built on a pasture-based feeding system.

Uruguay and Chile continue to grow as low-cost exporters, and Argentina, Ukraine and Belarus have the land base, but are missing the necessary elements of political stability and infrastructure.

And then there is Brazil with its pattern of getting in and out of the market.

The mix of global factors, from production and infrastructure to market development, bode well for the U.S., said Reed.

But how does the U.S. dairy industry leverage its existing capabilities to pursue these

emerging global markets?

Reed explained that, "If we stick with the status quo, we will be less competitive five years from now than we are today."

Back to the 'unmet demand' on the horizon for dairy... What types of products will be needed to meet that demand?

Whole milk powder is one of those key areas of product growth, and Reed indicated that the U.S. currently makes very little of this.

"The key to the future will be in turning milk into the products the world wants to buy," he said. "The good news is that future unmet demand is there for the taking, but it will give us prices that go higher and higher and then lower and lower."

An important element the U.S. dairy industry brings to the world marketplace is quality. Reed gave examples of casein and other products that have been imported into the U.S. over the years, and the quality issues associated with many of those shipments.

"The U.S. not only has the highest capacity in the world to grow its dairy supply, but we also have a diverse supply base, a relatively low seasonality in production, and a reputation for food safety and quality," said Reed. "Our shortcomings are that our product line does not align with what the world wants to buy, and we are 'in and out' of the global market. International buyers know when the price of milk is high when the U.S. calls to sell them product."

He alluded to the point that the traditional government support price system contributes to the 'in-and-out' mode of U.S. dairy exports to-date.

Not only do government support purchases interfere with the U.S. being a consistent exporter to the world market, they also foster the production of nonfat dry milk, which is not standardized nor consistent the way that skim milk powder and whole milk powder are.

"Buyers don't like our protein," he said.

"Buyers also don't understand how the U.S. prices its products. We make product to spec to sell to the government, not the customer."

The challenge for the future as dairy trade becomes increasingly global is for the U.S. to find a way to grow its dairy industry and reduce the milk price volatility that destroys farm incomes.

Even among the key dairy buyers here in the U.S., are global companies that "buy products globally," said Reed. "The risk we have is if we do not grow the domestic market at a steady pace and get involved in the global market, we will find ourselves in a weak competitive position (at home and abroad). That's why we believe the U.S. dairy industry should strive to become a consistent milk exporter."

From the 600-page study, Reed noted that preliminary recommendations focus on the U.S. adapting to become a consistent supplier—like Fonterra in New Zealand.

"We won't be the lowest cost producer, so we must show that we are better," he said. "That's a part of a consistent export strategy."

The reason DMI formed the Dairy Innovation Center and later the Global Task Force is to give producers a way to develop and communicate industry strategies with other sectors of the supply chain. The Global Task Force recommendations include these high-priorities:

- 1) Reforming regulated milk pricing systems and price support;
- 2) Development of mechanisms for risk management and the reduction of price volatility;
- 3) Continued pursuit of trade treaties that provide net export benefits;
- 4) Analysis and prospective redirection of industry's global, pre-competitive sales and marketing investments and capabilities;
- 5) Building on existing food safety assurances and traceability as a U.S. industry competitive strength;
- 6) Developing the ability to deliver customer product specifications (including review of current standards); and
- 7) Continued product and technology innovation (potentially with financial incentives).

On the 'hot button' issue of milk protein concentrates (MPC), Reed noted that, "We import a whole lot of MPC, around 49 million pounds on a protein basis, and we don't even make casein and caseinate at all here in the U.S. I submit to you that this is because we have cooperatives and companies making and selling NDM to the government."

"Be angry that it's getting imported, but it is meeting a specific consumer need," said Reed. "Don't vilify the ingredient. It's simply the taking of skim milk and pulling out the lactose and minerals to concentrate the protein.. This is a very large niche."

Look for more on the discussions of state milk pricing and the retail side of dairy from this PDMP Forum in next week's Farmshine.