Testimony of Robert Church

Legislative Responses to the Dairy Crisis: Reforming the Pricing Structure

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A dairy farmer's perspective on the current dairy crisis and potential remedies

Thank you for allowing me the opportunity to discuss with you the current economic crisis in the dairy industry. I commend your desire to address this issue by hearing first hand from all parties involved regarding the current milk price that farmers are receiving.

I am a partner and manager for Patterson Farms Inc. We are a 950 cow dairy and raise about half of the feed needed for our cattle. This farm has been in the Patterson family for 6 generations. The mission statement for our dairy has 3 key components that guide the decisions we make daily.

The 3 components are:

1. Profitability
2. Being an excellent place to work
3. Being good stewards of the environment and respected in the community

The last two of these key components we directly control. We can and do hold ourselves personally accountable for our performance. The first component in our mission statement (profitability), is much more difficult to control and has a direct effect on our ability to achieve excellent performance of the other 2 components. Milk price received at the farm level is the largest factor in the profitability equation. Our dairy family strives to attain a respectable profit. This is the single most important factor in our ability to sustain farming operations. Our situation today is not unique. The thoughts that I have outlined can be heard from almost all producers trying to market their milk in today's environment.

Fundamentally, the current problem facing farms is that revenues are not large enough to cover the expenses necessary to produce milk. This is resulting in producers using the equity in their businesses that would have been saved for retirement to finance daily operations. The only way to stay afloat at this time is to leverage more of our assets to support cash flow. This strategy will only work for a very short period of time. Many of our colleagues and friends have exited the dairy business because they have either run out of assets to leverage or have simply decided that they do not want to continue fighting the fight. Many of these farmers that have had or will have to exit the business are excellent managers and businessmen. A sad day has come when some of the best performers have to cut the show short because of circumstances out of their control.

My purpose here today is to provide a dairyman's view of the current situation and to express my opinions and suggestions for some options that may help dairy farmers experience some relief, both in the short and long term. The industry as a whole would benefit from more moderate milk price cycles. This is a very complex issue, finding a solution will require time and patience.

I will address the following issues outlined below during this testimony:

- Changing input costs
- Debt and financial health of dairies after extended down cycles
- FMMO's changing dynamics
- CCC usage of dairy and beef products
- Imports and Exports
- Milk Inventory Management Program

Changing Input Costs

Escalating input costs have eroded our ability to produce milk for what would have been a few years ago an acceptable milk price. Purchased feed costs are typically the biggest line item expense. Based on Farm Credit's Northeast Large Farm Benchmark Study we can see how dramatic these changes in feed costs have been. In 2006 the average purchased feed costs per cow were $978. In 2008 the average purchased feed costs per cow were $1445. This is a 47% increase just to this single line item in our budgets. With purchased feed costs making up approximately 30% of our total expenses, that one single factor erodes our ability to make milk economically. While farmers have seen a small amount of relief in the costs associated with feeding our cattle, the prices paid for our feed products are still at historically high levels. With the increased emphasis on ethanol, corn prices are still being held at high prices. Soybean prices typically trend like corn prices and are still at very high levels. Both of these commodities are staples in a cow's diet.

Labor costs are the next biggest line item in our budgets. It takes a reliable and compassionate workforce to care for our animals. In the same study referenced above we can see that labor costs per cow in 2006 were $639. That same number for 2008 was $770. This is a 20% increase. During that same time frame fuel costs have increased from $143 a cow in 2006 to $226 a cow in 2008. This is a 63% increase. This has a two-fold impact on dairy farmers, as we pay freight costs of inputs and outputs, making our situation unique. When we make purchases of inputs we pay the freight costs to have the goods delivered. When we sell our product we pay that freight cost as well. All invoices for goods received at our dairy have some sort of a fuel surcharge added that we must pay. We also have to pay an additional fuel surcharge for the goods that we are selling. Fundamentally this is wrong, we should not bear the burden of hauling expenses on both ends.

Increasing environmental regulation is another expense that we cannot underestimate. While I wholeheartedly support the efforts to protect our environment and natural resources there is a large expense that we burden to accomplish this task. Many farmers have had to take on large amounts of debt to adhere to these new standards. All of this increased attention to the environment is good; however it is an expense that is new and must be accounted for in the prices received for the milk we sell. In an effort to provide an acceptable standard of living for the owners and workers we must address the disparity between the price received for the milk we sell and the costs associated with the production of said product.

Debt and Financial Health

When the expenses are greater than the income there is only one option! That option is to borrow more money to pay for the expenses and this is how most farms are surviving the current situation. It is only a matter of time before the lending institutions stop lending money to struggling dairy farmers. Perhaps this time has come for some and will soon come for others. The effect of this cycle of low prices will have a profound impact on the future of dairy farms that survive. Many farmers are now experiencing losses in excess of $100 per cow per month. This is taxing our ability to remain in a financial position that will support sustainability. For a dairy with 950 cows that equates to $95,000 a month of capital usage solely for the purpose of paying regular occurring expenses, and no end is in sight. It will require strong prices for 3-4 years straight for farms to pay back this debt. Given the past performance of the dairy price cycle this is not likely to happen. Without some reform to our safety net levels and pricing structure we will undoubtedly continue to see the dairy industry struggle for a prolonged period of time.

Without changes to our current system our ability to support the needs of our citizens will be greatly hampered. This will result in the need to import more of our food ingredients from other areas of the world. It is this anticipated importation that will eventually lead the consumer to lose confidence in the safety of dairy products. This single thought process could have profoundly negative impacts on not only the dairy industry but all food supply industries as well.

Now is the time to address the financial health of our dairy industry. With rising input costs and record low prices the necessity to act is imminent. We as producers of America's nutrition cannot survive much longer without changes to the way milk is priced.

There are a number of existing policies and programs that should be modified to impact the short term and long term health of the dairy industry.

Federal Milk Marketing Order System

The price that farmers receive for their milk is primarily driven by the Class III milk price (milk used for cheese manufacturing) and the cheddar cheese spot prices as traded on the Chicago Mercantile Exchange. In the Northeast (Federal Milk Order I) we have seen that the utilization rate of Class III milk has increased over time. This change reflects the consumers using more cheese products in their diets. The original intent of the Federal Order System was built on the premise of Class I milk (fluid) being the primary use of dairy products. With changing marketing outlets and changing diets of the consumer we have seen over time that the usage of cheese products has increased and displaced some of the usage of fluid milk. This is normal market evolution and represents the changing needs of our consumers. The need to evaluate the Federal Milk Marketing Order (FMMO) is necessary to support prosperity of the dairy industry. This system needs to reflect not only the utilization of our products but also the costs associated with producing these products and raw ingredients. Changes to the FMMO might include; ensuring all milk produced is pooled in the order, changing the make-allowances to reflect input costs, putting the burden of transportation on the processor, and setting a floor support price for Class I milk.

MILC Program

Within the industry there is a lot of disagreement about the effectiveness of the MILC program. This program has surely help some farms during low milk price cycles but many other farms have not experienced much help from this program during low milk cycles. I would suggest that a better use of the assets from this program would be to support the efforts of the Commodity Credit Corporation. Increased consumer usage of dairy products will be the best way to help farmers obtain a higher price for their product.

CCC usage of dairy and beef products

The Commodity Credit Corporation (CCC) has the ability to affect the market in a profound way. With the current economic situation in the U.S. there are a large number of people relying on the government for their source of food. This factor is one that we should take advantage of for two reasons. The first is that it will help feed hungry people who cannot afford to provide for themselves and the second is that it will help use up some of the excess dairy inventory. Support of this program will benefit all parties involved. The largest limiting factor in the efficiency of this program is the packaging. The CCC can only buy products that are packaged to their standards. Processors have no real economic incentive to package solely for this program and therefore do not do so. The solution to this problem seems simple. The CCC needs to have the ability to purchase products that are packaged to the standards that are currently being applied to processing facilities. Support of this program would result in prompt changes in the price received at the farm for milk sold and have no negative impact on the product's consumers.

Imports and Exports

In respect to the global economy the U.S. dairy economy must be positioned to both receive imported milk products and export them as well. Many of the free trade agreements have helped to foster this global exchange. There are a few issues that should be addressed with these agreements however. The first issue to address is the enforcement of assessing imports the promotional fee. The money generated from the promotional fee that is assessed to all U.S. produced milk is used exclusively for the purpose of supporting and enhancing our domestic and international markets. All milk and milk components benefit from the use of this money. Imported milk products should not be exempt from this. Another issue to address would be assigning tariffs on milk product imports when we cannot compete in the global market. Our farms are held to higher environmental and quality standards than are many other dairy farm producers in the world. It is the cost associated with these standards that gives America's producers a competitive disadvantage. Milk Protein Concentrates continue to enter our domestic milk shed without regulation. These products need to become a part of the existing policies that regulate imports relative to U.S. demand. These will not be easy issues to tackle and will require careful planning and thought. There must be ways to narrow the disparity in prices without violating the agreements. In the short term the USDA should fully utilize the Dairy Export Incentive Program.

Milk Inventory Management Program

Numerous attempts have been made by leaders in our industry to better balance the production and the consumer usage of milk. Cooperatives Working Together (CWT) has been the most successful of these ventures. The acceptance of this program by producers highlights our willingness to help ourselves. Unfortunately CWT has not been able to prevent the current crisis that we are in today. Enhanced inventory management is a necessary component for a successful future in the dairy industry. This is an issue that will require a great deal of time to plan and execute. Long term a solid and reactive program will ensure that dairy producers can remain productive and competitive. A committee should be formed to assess the potential impact on the dairy markets and suggest a path to follow. This may or may not be a government run program but will require an intense oversight to ensure the outcome is desirable for all parties involved. It is too soon and much more information needs to be collected on this issue before a clear path can be seen. The leaders of our industry (both producers and processors) should be selected and appointed to take on this challenge. In the short term, supporting the efforts of risk management programs offered by our cooperatives will help dairy farmers secure their future.

In summary, the dairy industry is in a state of severe crisis. Food, air, and water are the essential elements needed to support life. It is the farmers in this country that provide the food. Without a united front to protect our natural resources our citizens will go hungry. Sustainability has become the latest buzz word and rightfully so. I would encourage all of us to band together, put aside individual agendas, and tackle the issues that threaten our ability to sustain our resources. Listed below are the key areas that need to take a high priority in our daily lives. I would invite and challenge each and every one of us to take control of our future and pave the path for sustainability.

<u>Key Focus Items</u>

- Address the FMMO, Make-Allowances, and entire pricing structure so that the cost of production at the farm level is taken into account.
- Put the burden of transportation costs of raw milk onto the processors.

- Set a Class I floor support price independent of the Class III price.
- Channel the resources currently applied to MILC in the CCC.
- Allow and encourage the CCC to purchase milk products as they are currently being packaged.
- Assess all imported milk and milk products a promotional fee.
- Classify Milk Protein Concentrates so that they are regulated by existing policies and are subject to an appropriate tariff structure.
- Encourage the USDA to fully utilize the Dairy Export Incentive Program.
- Form a committee to evaluate the concept and effects of a national milk inventory management program.
- Support risk management programs already in place for the dairy industry.