Agri-Mark, Inc.
40 Shattuck Rd, Suite 301
Andover, MA 01810

agrimark.coop
978.552.5500

Testimony for the Senate Agriculture Subcommittee on Livestock, Dairy, Poultry, Local Food Systems, and Food Safety and Security hearing on Milk Pricing: Areas for Improvement and Reform
September 15, 2021

By: Catherine H. de Ronde, Vice President, Economics & Legislative Affairs
Agri-Mark Dairy Cooperative
Andover, MA

Chair Gillibrand, Ranking Member Hyde-Smith, and members of the Subcommittee,

Thank you for inviting me to speak with you today. I am Catherine de Ronde, Vice President of Economics & Legislative Affairs for Agri-Mark, a dairy cooperative owned by more than 700 dairy farm families in New York and New England. Our cooperative has been marketing milk for dairy farmers since 1917 and actively represents their legislative interests in the Northeast and in Washington, D.C.

On behalf of our more than 700 farm families, thank you for spearheading this hearing and for the opportunity to testify before you today. Milk pricing is front and center for our farmers, particularly with the year we have just gone through. We applaud you for your continued support of our dairy farmers and industry, and greatly appreciate your efforts to secure the latest Pandemic Market Volatility Assistance Program (PMVAP) and Dairy Margin Coverage (DMC) adjustments. Your involvement and leadership to address the needs of the dairy industry is why I am here today and why it was important that Agri-Mark be a part of this hearing.

2020 was an outlier year for dairy markets. During my testimony today, I will highlight three elements of our Federal Order system that underscored the unprecedented year we had in dairy markets: negative Producer Price Differentials (PPDs), de-pooling, and the Class I mover. These challenges are the impetus for today's milk pricing hearing and why future conversations are so relevant. I commend the Committee for their time and commitment to these matters.

In my role at Agri-Mark, I engage with our members every day, discussing the current marketplace and forecasts. Milk pricing is something our farmers are particularly concerned about and something that Agri-Mark is actively involved in working to improve on a national level. Our cooperative is a member of the National Milk Producers Federation as well as the International Dairy Foods Association. I serve on the Economic Policy Committee of each organization, both of which are working on a number of these milk pricing and policy issues. Our producer chairman, James 'Cricket' Jacquier of Connecticut, serves on National Milk's Executive Committee as well.

In 2019, the industry started a deep dive into widespread reform conversations, until the pandemic put an abrupt halt to those efforts. Last year's extreme volatility and unique market circumstances unveiled some of the underlying flaws in our Federal Order system which has given the industry even more of a push to revisit the need for Federal Order reform. Areas for reform include the three areas discussed here today, along with others ranging from big picture to granular.

It is critically important that we recognize the intersections in milk pricing and how a change in one area can impact a change in another. While I deeply and personally understand the urgency to resolve our challenges, thorough analysis of these intersections, considering all perspectives, is essential in guaranteeing reform success. Changes should be made through the formal rulemaking process to ensure that a comprehensive approach is taken. The formal hearing process allows for producer, processor and consumer voices and perspectives to be heard and considered.

This hearing is an important step in the start of this dialogue on milk pricing issues. Once again, I thank you for your advocacy and investment in our industry and the opportunity to share my thoughts.

Agri-Mark's Footprint

Our cooperative is governed by our farmers. Agri-Mark's board of directors is comprised of 14 farmers elected by their peers, and the board sets the policies and strategic direction for the cooperative. Their mission is to guide our cooperative to ensure a more prosperous future for all members, employees and their communities.

We have approximately 720 members across Connecticut, Massachusetts, Maine, New Hampshire, New York, Rhode Island and Vermont. Agri-Mark has a strong presence in New York, where more than half of our membership and half of our milk volume comes from. We estimate that our New York members alone generate $905 million in annual economic activity.

Each year Agri-Mark markets around 370 million gallons (3.3 billion pounds) of fresh milk for our farm families. That milk is manufactured into nutritious high-quality dairy products at our four manufacturing facilities, or it is marketed to other regional dairy processors.

Agri-Mark operates three cheese production facilities and one butter/powder facility. Our award-winning cheeses and quality dairy products are marketed under the Cabot and McCadam brands which are sold across the U.S. Finally, our Agri-Mark Whey and Protein products are sold in more than 20 countries around the world.

Much of our New York milk is processed in our Chateaugay, New York cheese plant. This spring we broke ground on a $30 million modernization project that when completed will increase plant capacity, expand plant capabilities and improve efficiencies. Our board is investing in our Chateaugay facility to better support the growing needs of our local farmers, to meet the appetites of our customers and consumers, to provide an improved facility for our employees, and to ensure the quality of our award-winning cheese.

Agri-Mark employs more than 1,000 individuals and generates nearly $1 billion in annual revenues. Our manufacturing operations are economic generators in their respective rural New York and New England communities. Our cooperative business ranks #60 on the National Cooperative Bank's annual list of the top 100 co-ops in the U.S., and we are #12 on the Hoard's Dairyman top 50 dairy co-op list.

Dairy producer environment

Dairy farming is a 24/7 commitment 365 days a year. Besides physical labor, the mental and financial side of the business can be equally draining. There are the normal hurdles that generations of farmers have had to work through, from the imbalance of supply and demand to milk price fluctuations to the rising cost of inputs and beyond. As our nation and global economy has evolved in recent years, the dairy industry's traditional marketplace dynamics have morphed and become exponentially more challenging. The issues facing our nation's dairy farmers today are far more complex, encompassing the impacts that global trade has on our markets, labor pressures at all levels of the supply chain and changes in consumer appetites.

Dairy farmers are resilient, but they are not impervious to these compounding challenges. They've taken a toll and placed a tremendous amount of stress on our dairy farmers, their supply chains and their cooperative businesses. We have seen significant attrition in the industry during the last five years. Farmers are hanging up their hats. They're retiring. They're finding other occupations with less risk and more stability. We're seeing fewer new farmers and fewer transitions of farms passing from one generation to the next because the next generation does not want to shoulder the challenges that dairy farmers today must bear.

Why do we care? Dairy farmers and the dairy industry are critical to our local and regional economy, to our food value chain and to feeding the world. They provide sustainable nutrition, job creation, economic activity, land conservation, tourism and support for local food systems. They are part of the fabric and economic engine of our rural communities. Every cow creates $13,000 in economic activity for our region. Our dairy farms are far more than a picturesque backdrop for rural America; we need to ensure they have the markets as well as the right programs and tools to continue to operate and be sustainable for generations to come.

Our dairy farmers help feed America and play an increasing role in providing sustainable nutrition to the world. Collectively we must work together to ensure that our dairy supply chains (starting with farmers) stay strong and viable.

Safety net programs like the DMC program have proven critical to supporting dairy farmers through uncertain and volatile times. The collaborative efforts between the broader dairy industry and Congress have resulted in a tremendous amount of support in recent years. We applaud those efforts and in the same breath remind you that the effort is not over. There's more work to be done. We must continue to strengthen pricing mechanisms, provide aid to all farmers when needed, and build consumer trust domestically and in emerging markets across the globe.

Impact of pandemic on the dairy sector

Periods of low milk prices have plagued dairy farmers throughout history. During the period from 2015 through 2019 a series of market events caused milk prices to remain in a prolonged downturn, extending far beyond the historic three-year cycle farmers were accustomed to. As 2020 approached, conditions were finally improving, and all indications showed that 2020 would bring improved prices and much needed relief for dairy farmers. When the Covid-19 pandemic hit, markets took an unexpected and drastic turn. For dairy farmers, it could not have come at a worse time.

In the early days of the pandemic, safety and basic needs took top priority. For the first time in many of our lives, grocery store shelves were empty and food security became a widespread concern for many. Dairy farmers and plant workers came together to ensure our neighbors were fed, despite the uncertainty of their own health and that of their families.

While grocery shelves were bare, the market was flooded with milk due to the overnight loss of food service. Nearly half of the dairy industry's demand vanished temporarily, causing record amounts of milk dumping and requiring processors and distributors to make significant, immediate and costly adjustments to their operations. Milk prices plummeted. The U.S. average all-milk price went from $17.90 in March to $14.40 in April – the highest single month decline since the price recording began in 1980. In May, the price dropped further, reaching $13.70, the lowest price since 2010. There was a moment when we feared half our membership could be lost within months. It was a very frightening time.

Agri-Mark went to work advocating on our farmers behalf and seeking state and federal support. Alongside fellow cooperatives, industry associations, and our Congressional delegation, collectively we successfully secured a tremendous amount of federal support for dairy farmers. The Coronavirus Food Assistance Program (CFAP), the Farmers to Families Food Box Program (Food Box), Economic Injury Disaster Loan (EIDL) program and the Payment Protection Program (PPP) were all critical in turning dairy's economic outlook around.

Federal Orders

The Federal Order system provides significant value and safeguards to dairy farmers, cooperatives and processors. Federal Orders are critical to price discovery and orderly marketing. They ensure timely payment to dairy producers. Yet the industry has changed significantly since the last Order reform in 2000. Consolidation, industry growth, increased costs, and participation on the export market are all viable reasons to thoroughly revisit the Orders and revise them to better reflect today's marketplace. We want our Federal Order system to evolve with our industry and economy and be supportive of the needs of today's dairy participants.

The pandemic drew acute attention to three key shortfalls in our Federal Order system and has created an even greater urgency to revisit Orders. Negative PPDs had milk checks looking incredibly bizarre, de-pooling at a level never-before seen became a new phenomenon for many. The change to the underlying Class I mover was a key catalyst of these outcomes. For farmers, this showed up as unfamiliar milk checks, which caused a lot of unease and misunderstanding and had many questioning if our pricing system was working properly or not.

Negative PPD's. One of the major intents of Federal Orders is to put dairy farmers on an even playing field by pooling the value of all milk within an Order. The Producer Price Differential (PPD) is the mechanism to do so. PPD's are an accounting function and are an essential mechanism for revenue distribution within an Order. PPD's are positive when the total value of milk in a pool exceeds the total value farmers are paid for their milk components, and negative when there is a deficit of this value. While there are several reasons PPD's can be negative, I will focus on what occurred in 2020.

Keeping aside individual farmer components or location differences, farmers are paid on their Class III component prices and a PPD. The PPD is equal to the difference between the Blend price and the Class III price.

Under normal market conditions, Class I prices are the highest of the four class prices and drive blend prices (a weighted average of the four classes of milk) to exceed the Class III price. This means that after farmers are paid on a Class III component basis, there is excess value left in the pool, and this excess value is distributed via the PPD. Simply put, when blend prices exceed Class III prices, PPDs are positive.

Occasionally market conditions result in Class III prices spiking rapidly, which causes the Class III prices to exceed that of Class I prices and therefore blend prices. When this occurs, as it did in 2020 with the Food Box program implementation, the result was that after farmers were paid on a Class III component basis, more money was paid out than was available in the pool. To make the pool whole, the overpayment is balanced by the PPD. Simply put, when Class III prices exceed blend prices, PPDs are negative.

Farmers cringe at negative PPDs on their milk checks because they appear as a deduction that looks plain ugly. Yet in reality, the PPD is just a clearinghouse function that adjusts the milk check to reach the uniform blend price. PPDs serve an essential accounting function. They can be positive or negative, but they are necessary if we want to have Order pooling where farmers are paid for all the components in their milk. There is no doubt they are shocking and hard to stomach visually, but a negative PPD indicates that your Class III price was higher. Negative PPDs can pose challenges when it comes to risk management. Risk management decisions based on traditional pricing relationships can become problematic.

De-pooling. Another intent of Federal Orders is to eliminate farmers competing on where to send their milk. Before Federal Orders, every farmer sought to send milk to the highest valued Class I plant. Federal Orders were designed to eliminate this disorderly marketing among farmers by paying them uniformly, regardless of where they send their milk. This pooling takes place through the Producer Settlement Fund (PSF). Class I handlers must participate, while other classes may choose. This is because the Orders are designed to ensure the orderly marketing of milk used to produce fluid milk products, not milk used to make all products. Handlers pay in or draw from the PSF according to how they use the milk, at an amount equal to the difference between the announced blend price and the class price of the product they make. It is simply an exchange of money so that farmers are all paid the uniform blend price. This is what makes the system work.

Under normal market conditions, Class I handlers pay into the PSF while handlers of other classes draw from the PSF. This function is extremely important. Without it, non-Class I handlers would be unable to pay farmers the blend prices. In rare market circumstances, such as when Class III prices spike, the traditional PSF relationship flips and who pays in and who pays out reverses. When this occurs, there is a rule (each Order has its own) that allows for de-pooling. De-pooling rules allow for a non-Class I handler to remove a volume of milk out of the Order for a specified period of time. Under normal market conditions there is no benefit to this provision, as lower handlers want to be in the pool so they can receive money from the PSF to pay their farmers competitively. However, when normal relationships shift, there is a financial incentive to take advantage of these de-pooling rules to limit the amount of money flowing out of non-Class I handlers' hands and into the PSF. De-pooling reduces the blend price paid to all farmers who remained pooled in an Order. This was the case in 2020 after the implementation of the Food Box program which caused the Class III price to spike and the traditional PSF relationship to turn upside-down. De-pooling was prevalent, but varied throughout the country, as each Order has its own de-pooling provisions. The Northeast Order has the strictest provisions; therefore, the ability to use this tool within the Order is significantly limited.

Class I mover. The Class I mover calculation determines the Class I price. Class I prices have the highest value, drive blend prices higher, and are therefore an extremely important piece of a farmer's milk check. For many years, the Class I mover was equal to the "higher-of" Class III or Class IV. In other words, whichever of the two classes had the highest value, automatically determined the Class I value. This calculation was hugely beneficial for farmers throughout the years it was in place, always returning the best price to farmers.

In 2017, Class I bottlers asked the producer community for a change. They argued they were unable to effectively manage their risk because they never knew if their price would be based on Class III or IV. A group of stakeholder representatives reached a compromise. The agreed upon change, eventually included in the 2018 Farm Bill and put in place in May 2019 changed the formula to the average of Class III and IV plus 74 cents per hundredweight. Using the average solved the Class I bottler's need, and the addition of 74 cents was intended to make the change revenue neutral for farmers over time.

Before the start of the pandemic, the new formula kept farmers revenue neutral, operating as intended. However, the industry failed to anticipate the market impacts and ensuing government involvement in markets (the Food Box Program).

The result was a massive spike in Class III prices and an enormous spread between Class III and IV. This caused Class I prices to be significantly lower, thereby contributing to an incentive for de-pooling and even greater negative PPDs. The total producer impact from this change was roughly $750 million, $142 million of which occurred in the Northeast. The impact was felt by all farmers, regardless of farm size, and was an unintended and unanticipated consequence of changing the formula. The change was intended to give Class I bottlers the ability to manage their risk, while keeping farmers revenue neutral. The first of these goals was met, but revenue neutrality was not even close, and this must be addressed. Much effort is underway to revisit this formula for the future and to recoup the losses incurred from this change, both of which are top priorities for my member-owners. We are thankful for the recent USDA announcement of the PMVAP program which is expected to deliver approximately $350 of the $750 million lost income and hope that Congress will help to secure the remaining monies for the benefit of producers of all sizes and all regions.

Summary

2020 presented challenges none of us had ever lived through before, and that was certainly the case for dairy markets. Negative PPDs, de-pooling, and losses from the 2019 Class I mover change were front and center for dairy farmers. Conversations in the producer community, at the cooperative level and through the NMPF and IDFA Economic Policy Committees are underway. This hearing is an important step in the early stages of the dialogue on milk pricing issues. Milk pricing must be addressed comprehensively. The formal rulemaking process will ensure that all perspectives are taken into consideration and that individual milk pricing concerns are not looked at in a vacuum.

Once again, I applaud the Committee for their advocacy and investment in our farmers and our industry at large and thank you for the opportunity to share my thoughts with you today.

Catherine H. de Ronde