**United States Senate**
**Agriculture Committee**
**Subcommittee on Domestic and Foreign Marketing, Inspection, and Plant and Animal Health**
**Subcommittee on Production, Income Protection, and Price Support**
**Hearing on Responding to Low Dairy Prices:**
**Exploring Avenues for Federal Action**
**October 27, 2009**

**Testimony of:**


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**On behalf of:**
**Western United Dairymen**
**California Dairies, Inc.**


Good morning. Thank you Chairman Gillibrand, Ranking Member Johanns, Chairman Casey, Ranking Member Roberts, and other Members of both Subcommittees for holding this hearing. I appreciate the opportunity to provide testimony regarding the current state of the economy for dairy producers and to add some thoughts on potential short- and long-term solutions for our industry.

My name is Ray Souza, and my wife Lynette and I have operated Mel-Delin Dairy outside Turlock, California for more than 40 years. I started as a teenager with a 4-H cow I purchased at the local auction, and my family and I have made our living milking cows ever since. The milking herd today is roughly the average size for the state of California at about 900 head.

I currently serve as President of the Board of Directors of Western United Dairymen. Western United represents 1,100 of the 1,700 dairy farm families in the state of California. And I want to emphasize that word family. Even though we are known as a large-herd state, I can't think of a dairy that isn't owned and operated by a family.

We are members of the second-largest milk marketing cooperative in the country, California Dairies, Inc., and with our emphasis on purebred cattle I have been a member of the Holstein Association of America for more years than I care to think about, going back to that original 4-H cow. We have been fortunate to have some success in breeding registered Holsteins and merchandising genetics that have been in demand in the breed.

Today’s economic situation in the dairy industry in California is, in a word, dire. In fact, I’ll go back to that point about dairy families. A fifth-generation dairy farm family, my neighbors the Linhares, sold their cows this past summer in a CWT herd retirement round. One day in June, three generations were operating that farm. Today, after cows have been milked on that farm for 112 years, that family has left the business saying there is simply no way they could justify continuing to erode the equity they have built through five generations of caring for cows and working the land.

**I. An economic snapshot of the California dairy industry.**

**A. Ruinous negative operating margins.**

- Farm milk prices and feed commodity prices tend to be cyclical in nature. However, producers have never witnessed such dramatically low milk prices combined with skyrocketing production costs. The milk price/feed cost ratio is the lowest in history.
- The price paid producers for milk has been just over half what it costs to produce the milk for a large portion of the year. Dairy families are losing what took them years and even generations to build.

- The industry has experienced periods of low prices before. However, production costs have been on a steady upward climb – up 26% in California in just the last three years.
- The following chart, compiled with data from the California Department of Food and Agriculture, compares net operating margins from 2001 through 2008 and year-to-date for this year. While the last really bad year on the dairy farm, 2006, showed margins resulting in a loss of $3.30 per hundredweight, the negative margins year-to-date in 2009 are nearly two and one-half times larger.

| (per hundredweight) | CA Overbase Price | CA Statewide Cost of Production | Margin |
|---|---|---|---|
| **2001** | $13.11 | $12.24 | **$0.87** |
| **2002** | $10.24 | $12.61 | **-$2.37** |
| **2003** | $10.70 | $12.44 | **-$1.74** |
| **2004** | $13.89 | $12.75 | **$1.14** |
| **2005** | $13.17 | $13.43 | **-$0.26** |
| **2006** | $10.87 | $14.17 | **-$3.30** |
| **2007** | $17.27 | $15.77 | **$1.50** |
| **2008** | $16.03 | $18.54 | **-$2.51** |
| **2009 YTD** | $10.19 | $17.82 | **-$7.62** |

*Source: CDFA*

- These numbers are hardly unique to California. All U.S. producers will be higher-cost producers in the years to come as a result of the additional debt load taken on to survive these negative net operating margins. Productivity gains on U.S. dairy farms are nothing short of astonishing. Previous low price cycles have taken their predictable toll on operations that failed to control costs relative to their competing farmers serving the same markets. This cycle, however, is different. These ruinously negative margins are hurting everybody, including the most efficient.

**B. Monthly milk price v. input costs 2008 – 2009 and near-term projections.**

| (per hundredweight) | CA Overbase Price[1] | CA Statewide Cost of Production[2] | Margin (OB less COP) | CA Mailbox (plus marketing costs) | Margin (Mailbox less COP) |
|---|---|---|---|---|---|
| Jan-08 | $17.44 | $17.31 | $0.13 | $18.50 | $1.19 |
| Feb-08 | $16.72 | $17.31 | -$0.59 | $17.58 | $0.27 |
| Mar-08 | $16.01 | $17.31 | -$1.30 | $16.57 | -$0.74 |
| Apr-08 | $15.86 | $18.04 | -$2.18 | $16.43 | -$1.61 |
| May-08 | $16.77 | $18.04 | -$1.27 | $17.34 | -$0.70 |
| Jun-08 | $17.42 | $18.04 | -$0.62 | $17.90 | -$0.14 |
| Jul-08 | $17.35 | $19.21 | -$1.86 | $17.75 | -$1.46 |
| Aug-08 | $16.31 | $19.21 | -$2.90 | $16.81 | -$2.40 |
| Sep-08 | $16.22 | $19.21 | -$2.99 | $16.85 | -$2.36 |
| Oct-08 | $15.44 | $19.58 | -$4.14 | $16.30 | -$3.28 |
| Nov-08 | $14.27 | $19.58 | -$5.31 | $15.22 | -$4.36 |
| Dec-08 | $12.41 | $19.58 | -$7.17 | $12.83 | -$6.75 |
| Jan-09 | $10.40 | $18.51 | -$8.11 | $11.09 | -$7.42 |
| Feb-09 | $9.58 | $18.51 | -$8.93 | $10.32 | -$8.19 |
| Mar-09 | $9.84 | $18.51 | -$8.67 | $10.44 | -$8.07 |
| Apr-09 | $9.87 | $17.12 | -$7.25 | $10.40 | -$6.72 |
| May-09 | $9.76 | $17.12 | -$7.36 | $10.22 | -$6.90 |
| Jun-09 | $9.62 | $17.12 | -$7.50 | $10.15 | -$6.97 |
| *Jul-09* | $9.60 | *$17.12* | *-$7.52* | $10.12 | -$7.00 |
| *Aug-09* | $10.48 | *$17.12* | *-$6.64* | | |
| *Sep-09* | *$11.00* | *$17.12* | *-$6.12* | | |
| *Oct-09* | *$11.80* | *$17.12* | *-$5.32* | | |

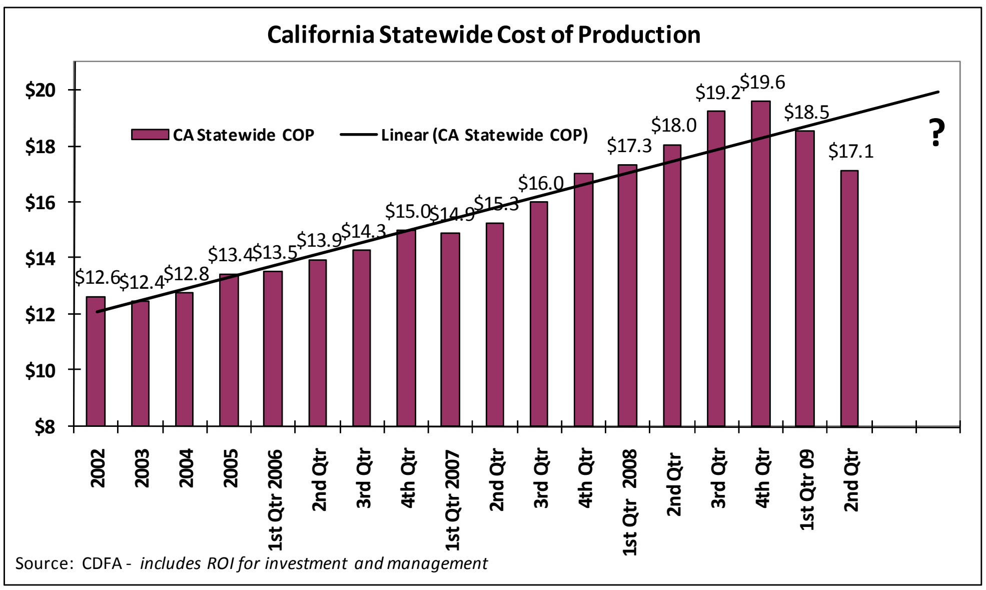
1 Actual through Aug and estimates for Sep and Oct 2009 (based on prices through October 22, 2009)
2 Actual through 2nd quarter 2009

Source: CDFA

- The dramatic increase in feed prices has propelled dairy production costs to record levels. Though feed costs have come down a bit, we expect this general upward trend to continue as the cost of doing business in California continues to rise.
- Production costs posted a slight decrease from 4th qtr 2008 to 1st qtr 2009, and then again into the 2nd qtr of 2009 due to slight decreases in feed costs. However, COP figures are not expected to decline by any significant amount as we move forward. Feed commodity prices that declined a bit over the summer have now risen sharply again, despite the projected record harvest of soybeans and near-

record corn harvest. The cash cost of production has returned to a record high for dairy farmers.

- California producers typically do not grow all their feed and have to pay additional transportation costs to haul in feed for their cows.
- At the same time, all other costs of doing business in California have increased. Additional environmental costs are mounting each year as producers work to meet new waste discharge requirements, for example.




**C. The crash came earlier to California.**

- The California milk pricing system responds more quickly to current market conditions because it corresponds to the Chicago Mercantile Exchange. In contrast, price reporting procedures for the Federal Milk Marketing Orders usually result in a one- or two-month delay.

## D. Outlook for the remainder of 2009 and into 2010.

- Market prices are moving upward but profitability remains a distant prospect for dairy farmers.
- The downward adjustment in milk production, made necessary by the disappearance of export markets caused by the global financial crisis, has finally kicked in nationwide. California producers, who felt the impact of lower prices two months before the rest of the country, also reduced production earlier. In fact, California milk production has been down year-over-year for 14 out of the last 15 months. September 2009 production in the state was down another 6.4% compared to September of 2008.
- Though prices are expected to increase in 2010, forecasts do not suggest a return to profitability for dairy farmers in 2010 – only smaller losses. Producers will continue to go out of business as it becomes clear that equity is gone and lenders reevaluate operating loans for next year with the looming likelihood of continuing negative margins.
- Those left standing will have a huge debt load to work through. It may take years of higher prices for the industry to recover.

## E. The dairy economic safety net is stretched flat on the ground.

- The Dairy Product Price Support Program (DPSP) is a long-standing program that is intended to benefit both producers when prices are declining and consumers when prices are rising. It also benefits all producers in the country equally without regard to herd size or farm location. Yet, at its current product purchase price levels the program is wholly inadequate considering the dramatic rise in input costs for farmers over the past three years. Prices have also fallen below support due to a lack of flexibility in the program. USDA must be provided the authority to increase prices at least temporarily to cover the initial costs associated with processing to Commodity Credit Corporation (CCC) standards. For example, cheese was below support on and off for much of this year yet not a pound of cheese has been sold to the CCC. Manufacturers participating in the California industry working group have pointed to inspection and grading standards as the major obstacle. This committee could help by asking USDA to align their product standards with those of the commercial market where possible.

- I do want to take this opportunity to thank Secretary Vilsack for the temporary product purchase price increases announced at the end of July. That move has helped strengthen market prices at very little cost to the federal government and it now makes sense that the increased prices be extended through the end of the current DEIP fiscal year of June 30, 2010. This will help maintain market strength that has just recently developed, particularly in the powder market.
- **Milk Income Loss Contract (MILC) Program –** while the payment helps pay some bills, the program continues to delay the supply reduction that must come. Unfortunately, the annual production cap of 2.985 million pounds of milk eligible for payment results in a program with only regional benefits. And the duration of this milk price crisis has turned what is intended to be a temporary life jacket for producers in rough economic waters into a long-term program with market-distorting effects that continue to delay the recovery that is so desperately needed by all dairy producers in all regions of the country.

- **Dairy Export Incentive Program (DEIP) –** I'd like to thank the many Members of the Senate Agriculture Committee for their help in securing implementation of DEIP by USDA. I would also like to point out the DEIP program is a good deal for the federal treasury. A 10-cent bonus to move a pound of nonfat dry milk to a foreign customer sure beats a 92-cents-per-pound CCC purchase. As of late July, for instance, 20,000 metric tons of U.S. dairy products had been sold to overseas markets with the help of DEIP bonuses totaling just $4 million.

**II. Steps the industry has taken to address the crisis.**

A. Western United Dairymen organized and hosted three industry listening sessions earlier this year. The purpose was to identify both short- and long-term solutions to the economic conditions in the industry. All producers in the state were invited and more than 200 took advantage of the opportunity at each meeting to provide input on issues such as supply management, federal and state milk marketing regulatory policy, and global markets and industry innovation.

B. At the conclusion of the series of three meetings, an industry working group was formed to analyze the ideas presented and provide recommendations going forward. Two meetings have already been held, with the working group taking the lead on requesting economic analysis of a supply management plan and agreement on recommendations for additional ways to address the milk price crisis.

C. Since early January, California dairy producers and their organizations have worked hard and have had the support of nearly every other dairy producer group in the country, as well as both Senators Dianne Feinstein and Barbara Boxer, in helping to persuade USDA to implement DEIP. Again, we say thank you to all industry partners in that successful effort, and to the Secretary as well as many Members of the Senate Agriculture Committee for your help.

D. We have supported the industry push to have the new Agriculture Secretary use all existing authority to increase demand for dairy products. That effort has shown some success, as well, as donations to domestic and international feeding programs were announced very quickly after the crisis began. This also helped in committing the over 200 million pounds of nonfat dry milk purchased by USDA. This product will no longer overhang the market.

E. **Cooperatives Working Together (CWT) –** California dairy producers have been early and consistent supporters of the industry-directed and -funded supply balancing program managed by National Milk Producers Federation. California Dairies, Inc., is a funding organization in CWT on behalf of its entire membership, and Western United Dairymen continues promoting the program to individual dairy producers whose milk marketing organizations are not members. The high percentage of milk produced in California that is covered by contributions to CWT demonstrates the commitment of our producers to the concept of a progressive industry supply-balancing self-help program. Much more remains to be done, however. Support for CWT remains at only two-thirds of the milk in the country. California producers have stepped up to the plate and are strong supporters of farmer self-help, including both the promotion and research checkoff and CWT.

## III. Potential Committee Action for Short-term Relief.

A. **Product purchases and donations to food banks –** In July, Western United Dairymen sent a request to Agriculture Secretary Vilsack for the purchase and donation of 100 million pounds of cheese. That request resulted from an analysis of cheese inventories that showed much higher volumes in storage than usual. It was clear to us then that those inventories were overhanging the cheese market and keeping farm milk prices down. Several other producer organizations and industry economists have since concurred with that conclusion. What was true then is still true today. A sizeable cheese purchase and donation would help food banks keep up with record demand, provide real assistance to dairy farmers in the form of a price increase on all of their milk instead of a direct payment on some of their milk, and reduce outlays from the federal treasury for the dairy farmer economic safety net. I come from an area where some counties have 15% to 16% unemployment. The food banks there sure could use that cheese.

B. **Full use of DEIP this fiscal year –** The Secretary has announced allocations and invitations for offers for the new program fiscal year in amounts equal to the unused allocations from 2008-2009. That is a helpful start and for that we say thank you again to the Secretary and to all those who helped make the case. The loss of export markets that hangs like a cloud over this milk price crisis remains a problem, however, and the remaining allocations for the current DEIP fiscal year will be a big help in rebuilding those international customer relationships. Western United Dairymen looks forward to working with this committee and the Secretary to make this valuable tool fully available to dairy exporters as the Congress has intended in every farm bill since 1985.

C. **Keep operating capital available –** Dairy farmers find themselves in a no-win situation in which they are unable to do the very thing that usually helps reverse a period of negative operating margins – they need to cull cows. But their lenders are operating in a new day as well, and there isn't the flexibility the banker once had to stick with even their best customers during a period of losses. The fact is that cows are worth about one-third less than they were a year ago, and that erodes a financial statement in a hurry. And if a dairyman culls cows in order to pay bills, that action could have a negative effect on the ability to borrow operating capital. Cows, facilities, and land are a dairy farmer's 401-k plan. The value of cows on dairy farms has dropped by more than one-third. Cows and bred heifers are worth $1,000 less than just 10 months ago. Newborn calves have dropped in value by $400 per head. The decline in the value of cattle amounts to a significant drop in dairy farmer equity totaling $2.6 billion dollars in California alone. The farmers who do survive must borrow against their remaining equity. That additional debt load will reduce the competitiveness of U.S. dairy farmers in global markets for the next several years.

**IV. Potential long-term solutions.**

A. **Supply Management Proposals –** The industry task force that was appointed to examine producer input from the three listening sessions held earlier this year has received and reviewed a proposal for a legislated supply management proposal known as the Holstein Association Dairy Price Stabilization Plan. The task force acknowledged the significant producer interest in a supply management plan and listed some questions to be addressed. The Western United Dairymen Board of Directors extended an invitation for, and received, a briefing on the plan from leading proponents. The Western United board has endorsed the concept and joins the task force members in posing some questions that must be addressed if producers are to be brought together to pursue legislation. WUD also formed a special committee of producer members to fully analyze the list of supply management and other policy proposals currently on the table. The committee (after two meetings) recommended to the board and the board approved and recently submitted comments and suggestions on draft language for the Dairy Price Stabilization plan.

B. **Fluid Milk Standards –** Several organizations offered a proposal during the last Farm Bill debate to raise nutrition standards in fluid milk nationwide. Interest in that proposal remains, due to the potential impact it could have on the need to balance supply and demand. This would benefit consumers by helping to alleviate the calcium crisis, it would reduce CCC expenditures in the DPSP, and the improved price stability would benefit farmers. The decades-long requirement for higher fluid milk standards in California is one of the most successful programs ever conducted in the U.S. dairy industry and it would be a big help to farmers and consumers alike if it were expanded nationwide.

C. **Industry Self-Help –** California dairy producers look forward to continuing to participate in a nationwide effort to identify long-term solutions to the current economic crisis. There is much more that could be done in producer-funded and -directed efforts at demand building, market balancing, and producer revenue assurance, for example.

Again, I thank the leadership of these two subcommittees for holding this hearing and for extending an invitation to hear from a California farmer. I look forward to answering your questions.