LEGISLATIVE RESPONSES TO THE DAIRY CRISIS: REFORMING THE PRICING STRUCTURES

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On behalf of the dairy farmer members of Agri-Mark Dairy Cooperative, I would like to thank you for holding this hearing and allowing farmers, their representatives and others to express their views on this important issue. This financial crisis has created serious problems for the current and future existence of the U.S. dairy industry.

Milk and dairy products pricing is already one of the most complex mechanisms in the marketplace, yet it remains unable to adequately address the problems of extreme price volatility and financial distress at the farm milk production level. Initially, I believe that the problems and legislative responses should be looked at from two levels. The first is the fundamentals of supply and demand that affect price levels. These include milk production decisions and actions on the farm, dairy product demand and the net impact of product mix and volumes of imports and exports. The second is the pricing structure itself that determines the prices paid to dairy farmers. These include the Chicago Mercantile Exchange (CME), USDA's National Agricultural Statistical Service (NASS) price survey and USDA's Federal Milk Marketing Orders.

Fundamentals of Supply and Demand

The relative relationship of the supply of raw milk relative to the demand for the dairy products made from that milk is the major factor in moving farm milk prices up or down. Because of the perishability of milk and the inelastic (almost fixed) demand for many of its derivative products (such as fresh drinking milk), small differences in supply and demand can result in large differences in prices. A general rule of thumb that I have used is that a two percent discrepancy in supply/demand balance often leads to a 20 percent change in price. This has worked in both moving milk prices up and down. While there is no documentation that this tenfold price impact still applies at larger imbalance levels, that certainly appeared to be the case when growing international demand for U.S. dairy products drove farm milk prices above $20.00 per cwt. in 2007 and then declining demand and small supply increases collapsed those prices below $12.00 in 2009.

Most dairy farmers have the freedom to choose how many cows they wish to milk and how much milk they wish to produce. Unlike in other commodities, dairy farmers in most areas, such as the Northeast, have rarely been hampered by the need to find a market if they planned on expanding. Federal Orders and cooperative marketing have played roles in those freedoms. However, because farmers have not taken into consideration the demand for their production, they pay a bitter price of severe price volatility and depressed income when more milk is produced than demanded at acceptable price levels.

While most farmers recognize this problem, they are very independent businessmen who do not like others restricting their farm business decisions. What many do not recognize is that the lack of any production discipline likely created more price related restrictions on their business than anything else.

When there is too much milk supply in the marketplace relative to demand, the marketplace sends a low price signal to lower supply. However, at each individual farm business, the message of low milk prices is often translated into a need to increase milk production in order to maintain cash flow. While this makes sense for a farm under the current pricing system, it makes the low price problem even worse. We need to find a system to send the correct signal to dairy farmers that allows them to make the best decisions for their farms and marketplace milk pricing. The industry is trying to reach a consensus on such a program as we speak. Almost assuredly, any such program would involve a mandatory participation program that could only be achieved by Federal legislation. We will keep the Agriculture Committee informed as this process moves forward.

On the demand side, dairy farmers and processors both contribute their own funds toward milk promotion. This is allowed through Federal legislation and our farmer cooperative supports such endeavors. The failsafe for milk prices on the demand side is supposed to be the dairy price support program that has been in operation since 1949. However, such prices peaked in the early 1980's at over $13 per cwt., but were lowered to below $10 per cwt. and have remained there for more than two decades until USDA acted a month ago.

I usually describe the price support program as a safety net lying untethered on a concrete floor. If the price hits that level, the damage done to farm operations is usually extreme. Efforts by many legislators, including our own Northeast Senators, to urge USDA Secretary Vilsack to temporarily raise the support prices for cheese and powder were needed and greatly appreciated.

We also support the amendment to the Senate Agriculture Appropriations Bill that would give USDA an additional $350 million beginning in October to further strengthen the price support program. We appreciate all the efforts of our Senators to achieve this and are urging their counterparts in the House to support it. <u>It is important that the USDA use these funds to actually purchase dairy products to increase demand and lessen the burden of high inventories built up earlier this year.</u> It was a great disappointment to see the market price for cheese fall below the support price for much of this year, yet not a pound of product was sold to the CCC. I believe that the support price was used by many in the industry as a benchmark to set the market price, not as an alternative outlet for milk supplies. Had the cheese support price been 10 or 20 cents higher throughout this year, I estimate that little if any cheese would have still been bought by the CCC. With food banks and other low income feeding programs clamoring for product donations, CCC cheese purchases would have found a welcome home and would not be around now to further aggravate supply and demand imbalances this fall. Perhaps offering to buy under the support program is no longer enough and actual purchases need to occur.

International markets for U.S. dairy products offer a great opportunity to increase the demand for domestic milk supplies. However, they can also backfire on the industry as when those exports were the first to be cut back during the international recession. Overall however, we believe that there remains great opportunity in exports markets over time. While there is great concern over imports of dairy products into this country, the problem is likely not as severe as some people believe. New York Senator Schumer's bill to restrict casein and other imports is well meaning, but may cause more harm than good as a backlash from other countries may occur. We look forward to working with him and other Senators to address any problems that may develop with that bill.

Milk Pricing Structure

Currently, most of the milk in the country is priced relative to the Chicago Merchantile Exchange's cheese and butter markets. While Federal Orders use a dairy product weekly survey price from USDA-NASS, the plants who are surveyed use the CME prices to set their own prices, plus or minus a product or quality differential. If CME prices fall a dime, almost assuredly the NASS prices will fall a similar amount within the two week lag period. The problems do not so much lie with the CME as is does with an industry that accepts CME price changes on marginal loads of product as the price indicator on all loads of products. <u>We absolutely need more work done to address this issue.</u>

Federal Milk Marketing Orders use a complex set of formulas administratively set as a result of public hearing and industry testimony and evidence. However, Federal Orders are primarily the messenger of prices changes, not the cause. The one exception, however, involves Class I pricing for fresh drinking milk. Federal Orders were originally enacted to assure an adequate supply of fresh drinking milk for consumers through orderly marketing of milk and farm prices that would sustain that supply. We have tried several times to amend Federal Orders to raise the effective Class I price as milk production costs have risen and floor the Class I prices as huge swings in cheese and other dairy products prices have caused Class I prices to fall even farther below milk productions costs. While we appreciate the provisions of the 2008 Farm Bill that speed up the Federal Order decision making process, we also need USDA to take into consideration milk production costs when setting Class I price levels.

Supplemental to the pricing structure are programs such as the Milk Income Loss Contract program in effect since 2002. This was a program that originally took many aspects of the highly successful Northeast Dairy Compact and used them to set a direct payment program for dairy farmers. This program has been crucial to most farmers during the severe price downturns over the past seven years. The MILC feed price adjustor also helped this year, but could be crucial if the feed price levels of 2008 return. <u>However, the program would be further improved if it used a cost of production indicator as the price trigger in place of the $16.94 Boston zone Federal Order Class I price</u>. Keep in mind that that price came from the Northeast Dairy Compact program and was set over 12 years ago! In addition, we support Senator Shaheen's amendment to allow larger volume payment caps for multi-family dairy farms.

Agri-Mark members appreciate all of the efforts of our Northeast Senate delegation and particularly those serving on the Agriculture Committee. Much work needs to be done and we are confident that our elected leaders are up to the task. Thank you.